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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

AERONAUTICAL RADIO, INC., and
AIR TRANSPORT ASSOCIATION OF AMERICA,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.,
Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Appendix A

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-1333

AERONAUTICAL RADIO, INC., ET AL., PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA, RESPONDENTS

AMERICAN BROADCASTING COS., INC., ET AL.
AMERICAN TELEPHONE AND TELEGRAPH CO.
MICROWAVE COMMUNICATIONS, INC.
WESTERN UNION TELEGRAPH COMPANY, INTERVENORS

No. 77-1521

AERONAUTICAL RADIO, INC., AND
AIR TRANSPORT ASSOCIATION OF AMERICA, PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA, RESPONDENTS

AMERICAN TELEPHONE AND TELEGRAPH COMPANY
CONSOLIDATED RAIL CORPORATION
MICROWAVE COMMUNICATIONS, INC. AND
MCI TELECOMMUNICATIONS CORP.
AMERICAN NEWSPAPER PUBLISHERS, ET AL. INTERVENORS

No. 77-1544

GENERAL ELECTRIC COMPANY, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

AMERICAN TELEPHONE AND TELEGRAPH COMPANY MICROWAVE COMMUNICATIONS, INC., ET AL. INTERVENORS

No. 78-1368

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS

AMERICAN BROADCASTING COMPANY, INC. & CBS, INC., & NATIONAL BROADCASTING COMPANY, INC. DOW JONES & CO., INC., INTERVENORS

Petitions for Review of Orders of the Federal Communications Commission

Argued February 27, 1979

Decided June 24, 1980

Ron M. Landsman, Attorney, Department of Justice, with whom *Robert B. Nicholson*, Attorney, Department of Justice, was on the brief for respondent, United States of America.

John L. Bartlett with whom *Charles R. Cutler*, *Michael Yourshaw*, *James E. Landry* and *William E. Miller* were on the brief for petitioners in Nos. 77-1333 and 77-1521.

Joseph M. Kittner, *Edward P. Taptich* and *Lawrence J. Movshin* were on the brief for petitioner, General Electric Company in No. 77-1544.

John E. Ingle, Counsel, Federal Communications Commission, with whom *Robert R. Bruce*, General Counsel, and

J. Saylor, Deputy General Counsel and *Daniel M. Armstrong*, Associate General Counsel, Federal Communications Commission, were on the brief for respondent, Federal Communications Commission.

Richard J. Flynn, Joseph B. Tompkins, Jr., William G. Schaefer, David J. Lewis, Jules M. Perlberg and *Alfred A. Green* were on the brief for intervenor, American Telephone and Telegraph in Nos. 77-1333, 77-1521 and 77-1544.

Norman P. Leventhal, Joseph De Franco and *Howard Monderer* were on the brief for intervenor, American Broadcasting Co., Inc., et al. in No. 77-1333.

Also *Werner K. Hartenberger, Daniel Armstrong*, Counsel, Federal Communications Commission, entered appearances for respondent Federal Communications Commission.

Also *Barry Grossman* and *James F. Ponsoldt*, Attorneys, Department of Justice, entered appearances for respondent United States of America.

Also *Michael H. Bader, Kenneth A. Cox, William J. Byrnes* and *Raymond C. Fay* entered appearances for intervenor Microwave Communications, Inc. in Nos. 77-1333, 77-1521 and 77-1544.

Also *Joel Yohalem* entered an appeaarnce for intervenor, Western Union Telegraph Company in No. 77-1333.

Also *Richard M. Rindler* and *Russell L. Smith* entered appearances for intervenor, Consolidated Rail Corporation in No. 77-1521.

Also *Aloysius B. McCabe, Michael Yourshaw, John R. Baskin* and *Herbert M. Schulkind* entered appearances for intervenor, American Newspaper Publishers, et al. in No. 77-1521.

Before BAZELON, *Senior Circuit Judge*, ROBB and WILKEY, *Circuit Judges*.

Opinion for the Court filed by *Circuit Judge* ROBB.

Opinion filed by *Circuit Judge* WILKEY, dissenting in part.

ROBB, *Circuit Judge*: This case comes to us on petitions for review of eight rulings of the Federal Communications Commission [1] dealing with (1) general ratemaking principles and (2) American Telephone and Telegraph Company's (AT&T's) TELPAK offering. In response to the arguments of the parties, we (1) uphold the Commission's selection of fully distributed costs as its primary costing methodology; (2) vacate certain findings of the Commission with regard to specific rates and past rate levels; (3) uphold the Commission's procedures; and (4) reverse the Commission's denial of petitions to reject a certain tariff filing.

I. BACKGROUND

AT&T provides two major categories of interstate service: public switched message service and private line service. Public switched message service is of two types, long distance message telecommunications service (MTS) and wide area telecommunications service (WATS). Under MTS (the ordinary "long distance" call), the user dials his call or is assisted by an operator and pays for the service on a per-call basis. Under WATS (a variant of MTS) the customer makes direct dialed calls anywhere within a specified service area at a monthly rate. MTS and WATS are essentially monopoly services in which AT&T does not face competition.

Private line service is of several types, primarily telephone, telegraph, audio and video program transmission

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[1] *In the Matter of American Telephone & Telegraph Co., et al.*, (F.C.C. Docket No. 18128): 61 F.C.C.2d 587 (1976); 42 Fed. Reg. 8178 (1977); 64 F.C.C.2d 971 (1977); 65 F.C.C.2d 621 (1977); 67 F.C.C.2d 1441 (1978). *In the Matter of American Telephone & Telegraph Co.* (Transmittal No. 12714): 64 F.C.C.2d 958 (1977); 64 F.C.C.2d 959 (1977); 65 F.C.C.2d 7 (1977).

and data transmission services. These services provide the customer with continuous communication between fixed points without the necessity of establishing a new circuit for each message. Unlike MTS and WATS, several specialized carriers compete against AT&T in the private line service market.

A. *Docket 14251*

By the end of 1960, it appeared to AT&T's larger private line customers that it might be cheaper to construct their own private microwave systems than to pay AT&T's private line rates. To head off this potential diversion of traffic, AT&T, in January 1961, filed tariffs for TELPAK service. Under TELPAK, a customer with substantial requirements for private line service between two points may order that service on a bulk basis, at relatively less expense than if he were to order an equivalent number of channels on an individual basis.[2] As originally filed, TELPAK was of four types—A, B, C, and D. These types provided, respectively, twelve, twenty-four, sixty, and two hundred forty voice-grade channels.[3] TELPAK A and B were subsequently eliminated for reasons which do not presently concern us. With regard to TELPAK C and D, the Commission found that they were justified by competition, but ordered further proceedings to determine whether they were compensatory, i.e., would bear their own costs or would be a burden on other customers of the company.[4] Unfortunately, as of 1967 the FCC had not established any ratemaking standards for determining whether a

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[2] For a detailed description of TELPAK and how it works, see American Trucking Associations, Inc. v. F.C.C., 126 U.S. App. D.C. 236, 239-42, 377 F.2d 121, 124-27 (1966), *cert. denied*, 386 U.S. 943 (1967).

[3] For a description of voice-grade channels, see *id.* at 240-41, 377 F.2d at 125-26.

[4] Telpak, 37 F.C.C. 1111 (1964).

service was compensatory and consequently the FCC closed out Docket 14251 and transferred this issue, as it applied to TELPAK C and D, together with the entire record in Docket 14251, to a new proceeding—Docket 16258.

B. *Docket 16258*

In October 1965 the FCC began an investigation of the rates and services of AT&T in its *General Telephone Rate Investigation* (Docket 16258). Phase 1-B of that investigation was designed to establish general ratemaking principles.[5] Of particular interest was whether fully distributed costs (FDC) and/or long-run incremental costs (LRIC) should be the appropriate measure of costs for ratemaking purposes.[6]

After lengthy hearings on the general issues of ratemaking and costing principles, the Commission initiated a conference among the parties, hoping they could reach a mutual agreement on the issues. These parties agreed to a "Statement of Ratemaking Principles and Factors" but the Commission did not approve this Statement; rather in July 1969, the Commission "noted" it.[7] At the

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[5] Once these ratemaking principles were established, it was intended that it would be determined whether TELPAK was compensatory.

Phase 1-A of the investigation related to AT&T's then current interstate rate of return and interstate rate base, see 9 F.C.C.2d 30, 9 F.C.C.2d 960 (1967), but is of no further interest to us here.

[6] The measurement of long-run incremental costs (LRIC) involves computing all directly attributable investment and expenses incurred for the purpose of furnishing a particular service, including any additional common costs. Fully distributed costs (FDC) include not only the directly attributable costs, but also an allocation of costs which are inherently unattributable to any service.

[7] 18 F.C.C.2d 761, 764 (1969).

same time, the Commission folded the entire records of Docket 14251 and Phase 1-B of Docket 16258 into a third proceeding begun the prior year to investigate the lawfulness of substantial rate increases for TELPAK C and D —Docket 18128.[8]

C. *Docket 18128*

Docket 18128 was opened in April 1968 to consider, as noted above, the lawfulness of rate increases for TELPAK C and D, which had been filed in March 1968. 12 F.C.C.2d 1028 (1968). Eventually the Commission was to consider in Docket 18128 a number of other matters in addition to Phase 1-B of Docket 16258 (and the attendant record from Docket 14251). These matters consisted of (1) almost all AT&T's other private line tariffs, 13 F.C.C.2d 853, 857 (1968); (2) new private line tariff revisions filed in October 1969, 20 F.C.C.2d 383, 388 (1969); (3) other tariff revisions for private line services filed in December 1971, 33 F.C.C.2d 522, 525 (1972).

Hearings in Docket 18128 were concluded in August 1972 and the record closed that December. More than three years later, the Chief, Common Carrier Bureau, on January 19, 1976 issued the Recommended Decision, 41 Fed. Reg. 4320. Following the filing of exceptions to the Recommended Decision, the Commission on October 1, 1976 issued its Final Decision, 61 F.C.C.2d 587, supplemented by its Rulings on Exceptions, issued February 1, 1977, 42 Fed. Reg. 8178.

In this Final Decision the Commission held as follows:

(1) Fully distributed costs, rather than long-run incremental costs, should be the primary standard by which to judge rate levels for interstate service. 61 F.C.C.2d at 589-90, 633-49. From the seven different FDC

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[8] *Id.* at 764-65.

methodologies of record, the Commission selected FDC "Method 7" as that primarily to be used. *Id.* at 668.[9]

(2) The Commission prescribed certain guidelines under 47 U.S.C. § 205 (1976) consistent with its adoption of FDC over LRIC. 61 F.C.C.2d at 659-67.

(3) The Commission found that the present return levels for the television, audio/radio, private line telephone, and private line telegraph service categories were unlawful and that "[p]ast return levels for these services are generally . . . found to have been unlawfully low, although in some years the return level of certain services could have been considered to have approached the zone of reasonableness." 61 F.C.C.2d at 590. *See id.* at 651-52.

(4) The Commission held that the rate differentials embodied in TELPAK C and D were unlawful because they were not justified by competitive necessity; accordingly the Commission ordered that TELPAK be eliminated by June 8, 1977. 61 F.C.C.2d at 657-59, 668-69.

At this point in our chronology of events, a slight diversion must be made. Concurrently with its proceedings in Docket 18128, the Commission was conducting a separate rulemaking proceeding in Docket 20097, regarding the broad issue of whether resale and sharing of telecommunications services should be required. "Sharing" is a joint use arrangement in which several users collectively use communications services and facilities provided by a carrier, with each user paying according to

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[9] The seven methods evolved over the years, with "Method 1" appearing in 1965. The later developed allocation methods, exemplified by Method 7, were designed to distribute costs more on the basis of historic cost responsibility. The earlier methods, exemplified by Method 1, were designed to distribute costs more on the basis of relative use. See 61 F.C.C.2d at 642-44.

its proportionate use. "Resale" is a commercial device whereby one entity subscribes to the communications services and facilities of another entity, and then re-offers these services and facilities to the public. *See* 60 F.C.C.2d 261, 263, 274 (1976). Finding that unlimited sharing and resale were appropriate, the Commission ordered the carriers to publish new tariffs, to be effective June 21, 1977, providing for resale and unlimited sharing of all private line services, including TELPAK. See 64 F.C.C.2d 1003, 1004 (1977).

It appeared to AT&T that a requirement of resale and unlimited sharing would destroy the economic viability of the TELPAK bulk rate offering. It was believed that in a resale and unlimited sharing environment, single-channel private line users would enter into joint use arrangements (sharing) or start purchasing resold TELPAK in order to take advantage of the lower bulk rates. This would result in the provision of substantially all voice-grade private line services at the lower TELPAK rates regardless of whether individual users would normally qualify for bulk communications services. AT&T believed that under these conditions the single-channel private line rates developed specifically on the basis of single-channel usage patterns would be meaningless, and as a practical matter would be eliminated.

Now we return to the main narrative. On March 23, 1977 AT&T filed, under Transmittal No. 12714, tariff revisions providing for the termination of TELPAK on June 8, 1977. In its letter of transmittal, AT&T noted that this action was consistent with the order in the Final Decision in Docket 18128 that TELPAK be eliminated by June 8, 1977, but was also precipitated by the impact of the rulings providing for sharing and unlimited resale by June 21, 1977. As the Transmittal stated, "It is our [AT&T's] view that Telpak cannot exist in a resale and sharing enviromnent". (J.A. 445) It is noteworthy

for purposes of the petitions before us that Transmittal No. 12714 did not include supporting data under Section 61.38 of the Commission's Rules. (47 C.F.R. § 61.38)

D. *First Order on Reconsideration*

In an order first announced at an open meeting on June 1, 1977 and adopted on June 6, 1977, the Commission in several respects reconsidered its Final Decision in Docket 18128. 64 F.C.C.2d 971. Of most significance, the Commission revoked its order that TELPAK be eliminated, and ordered that new proceedings be undertaken to determine the lawfulness of that offering. Also, the Commission, in a departure from its Final Decision,[10] considered and declared unlawful the revisions in the following rates and rate elements within the private line service categories: (1) increases in rates for teletypewriter station equipment, effective November 1, 1968; (2) changes in the TELPAK telegraph/telephone equivalency ratio, effective September 1, 1968 and February 1, 1970; and (3) various elements of the rates in the private line telephone, private line telegraph, and TELPAK offerings, effective May 4, 1972. In each instance, the basis of the Commission's decision was that AT&T had failed to meet its burden of proof (which required that it show that the rates were justified), primarily because it had relied on long-run incremental cost studies. 64 F.C.C.2d at 989-91.

E. *Petitions to Reject*

AT&T's March 23, 1977 tariff filing under Transmittal No. 12714, providing for termination of TELPAK,

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[10] In the Final Decision, the Commission had indicated that the issues in Docket 18128 had been narrowed so as to exclude the issues of specific rates. 61 F.C.C.2d at 596 & n.36; *Rulings on Exceptions*, 42 Fed. Reg. 8178, 8199 (1977) (Rlgs. on UPI Excpt. 1-4, AP Excpt. 9).

brought forth a number of pleadings from TELPAK users, requesting the Commission to suspend and investigate or reject the tariff revisions. These petitions raised a number of issues to be discussed later in this opinion. By an order adopted June 2, 1977 the Commission denied the petitions. 64 F.C.C.2d 959. The Commission noted that, although AT&T was no longer under compulsion to terminate TELPAK, the Commission having revoked its order requiring that termination, AT&T had independently concluded that TELPAK should be eliminated because of the provision requiring sharing and unlimited resale. 64 F.C.C.2d at 961; *See also* 64 F.C.C.2d 971, 986-87.

Following the Commission's decision on Transmittal No. 12714, Aeronautical Radio, Inc. and General Electric filed petitions for review in this court and, along with the Department of Justice on behalf of the government agencies as TELPAK users, sought temporary relief pending judicial review. Meanwhile, in view of the Commission's revocation of its order to eliminate TELPAK, AT&T, with the Commission's approval, extended the date for the termination of the TELPAK offering from June 8 to June 21, 1977, the effective date of the resale and shared use orders as they applied to TELPAK. Subsequently, on June 17, 1977 the Court of Appeals for the Second Circuit stayed the resale and shared use orders (as applicable to TELPAK) until July 22, 1977. Thereupon AT&T once again extended the effective date of the TELPAK termination until July 22, 1977.

A further stay of the Commission's resale and shared use orders was denied by the Second Circuit Court on July 21, 1977. On that same day this court denied the various motions filed by the TELPAK users, seeking a stay, mandatory injunction, and summary reversal of the Commission's decision which allowed AT&T's Transmittal No. 12714 to take effect. However this court on July

21, 1977 ordered, *sua sponte*, that AT&T be "enjoined from discontinuing the Telpak offering to customers served and under the terms and conditions existing as of the date of this order," pending this court's review of the Commission's order on Transmittal No. 12714. Pursuant to our order, AT&T filed with the Commission tariff revisions which (1) provided that the TELPAK offering be discontinued as of July 22, 1977 in accordance with AT&T's previous tariff filing which the Commission had declined to suspend or reject, but (2) preserved the terms and conditions of the TELPAK offering as to existing customers. Thus, the status quo of the TELPAK offering has been maintained during the pendency of judicial review.[11]

On January 26, 1978 the Court of Appeals for the Second Circuit affirmed the Commission's resale and shared use orders, and the Supreme Court thereafter denied petitions for a writ of certiorari. *American Tel. & Tel. Co. v. FCC*, 572 F.2d 17 (2d Cir.), *cert. denied*, 439 U.S. 875 (1978).

II. Analysis

We will discuss the issues in an order which does not necessarily correspond to the order in which they arose in these proceedings.

A. *FDC v. LRIC*

The Department of Justice filed a brief on behalf of the United States as a statutory respondent; it did not file a petition for review on behalf of any agency which

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[11] This court has subsequently denied a motion requesting that AT&T be required to offer Telpak under the terms and conditions of unlimited resale and sharing (Order, August 18, 1977) and denied a motion seeking the expansion of the Telpak offering to new customers (Order, April 11, 1978).

it represents. *See United States v. ICC*, 337 U.S. 426 (1949). Nevertheless the Department contends that the Commission acted arbitrarily and capriciously in adopting fully distributed costs as its costing methodology. We reject this contention and affirm the Commission with respect to this issue.

We emphasize that the question is not whether this court, if it were examining the merits of FDC Method 1, FDC Method 7, LRIC, or any other method, as a matter of first impression, would have selected one over the others. Rather, the question is whether the FCC made a reasonable selection from the available alternatives. The court does not substitute its judgment for that of the agency, but merely confines the agency within the areas within which it may reasonably exercise its discretion. *See Greater Boston Television Corp. v. FCC*, 143 U.S. App. D.C. 383, 393, 444 F.2d 841, 851 (1970), *cert. denied*, 403 U.S. 923 (1971). And of course the Commission has broad discretion in selecting methods for the exercise of its powers to make and oversee rates. *FPC v. Texaco, Inc.*, 417 U.S. 380, 387-89 (1974); *Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968).

In Docket No. 18,128 the Commission attempted to deal with AT&T's ratemaking in a way that would permit the company to compete fully in any markets without allowing it to use revenues from captive monopoly markets as a source for cross-subsidies. To accomplish this it was necessary for the Commission to learn as much as possible about the relevant costs of providing the different classes of service. The question was, which costs were relevant.

The Commission found that the relevant costs were fully distributed costs, which it prescribed as the standard for judging AT&T's rates. We cannot say that this standard is either impermissibly rigid and restrictive of

AT&T's ability to compete, as the Department of Justice contends, or impermissibly vague as AT&T argues. We recognize that the Commission will not allow rates to depart from full costs without a strong public interest showing, and that guidelines remain to be worked out in negotiations with the FCC staff and in Commission actions on specific rate filings. We think however that the Commission's standard is both sufficiently flexible and sufficiently informative.

The Commission explained that FDC was in its judgment the standard most consistent with its regulatory responsibility and objectives. 61 F.C.C.2d at 589. In particular, the Commission found:

1. That knowledge of the full costs of service is essential to holding the carrier accountable for investment and pricing decisions, which, in turn, is the "touchstone" of just and reasonable ratemaking. 61 F.C.C.2d at 609-12.

2. That allocation of full costs to each service, with exceptions where "cost economies will be realized and can be demonstrated," is essential to avoid discriminatory pricing. *Id.* at 612-14, 626-27, 632-33.

3. That full cost definition and allocation are consistent with encouraging efficiency and innovation in providing service. *Id.* at 614-15.

4. That full cost standards are essential to enable potential and actual competitors to judge the attractiveness of markets with full knowledge of the "market rules." *Id.* at 615-18, 632-33.

Conceding that there was no perfect set of principles and that other methods than FDC also were plausible, *id.* at 606-07, 668, the Commission concluded:

> [I]n order to determine whether rate levels and rate level relationships are just, reasonable or not unduly

> discriminatory the actual full costs of providing service must be known and certain, irrespective of whether rates are in direct relationship to costs or depart therefrom. In the latter case the ascertainment of actual full costs still provides the relevant standard to aid in the determination of lawfulness of rates.

Id. at 668.

The Department of Justice appears to assume that FDC pricing erects a "protective umbrella" over new entrants in private line markets, leaving AT&T with "virtually no freedom" to price competitively. (DOJ Br., pp. 34-40) The Department says the Commission's failure "rationally to consider" this effect on competition in private line markets requires reversal.

In fact, competition was central to the proceeding. A prime objective was to establish market rules for established and emerging carriers.[12] And the agency was at pains to avoid placing a "protective umbrella" over new carriers. 61 F.C.C.2d at 615-19. On the other hand there was legitimate concern that failure to "get a handle" on AT&T's costs would enable the company to use cross-subsidies from monopoly services as an "anticompetitive 'protective umbrella'" of its own. *Id.* at 616.

In the end, the FCC found that LRIC pricing, whatever its merit in a purely competitive environment, should

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[12] This court had underscored the importance of the factor of competiiton in its order requiring the expeditious resolution of Docket No. 18,128:

> [T]he very reason for the Commission's 1965 rate investigation into AT&T's rates was the seven-way cost study which showed wide variations among the returns earned by AT&T's investment in monopoly and competitive service.

Nader v. FCC, 172 U.S. App. D.C. 1, 25, 320 F.2d 182, 206 (1975). *See also, id.* at 29-30, 520 F.2d at 210-11 (Fahy, J., dissenting).

not be applied selectively to AT&T's competitive services in a manner that would burden monopoly service customers with all residual costs. *Id.* at 627-49. The Commission also considered and rejected the Defense Department's "alternative" marginal costing approach, finding it to have essentially the same defects as AT&T's LRIC. *Id.* at 632 n.77. Defense urged the adoption of FDC Method 7 if incremental costing were not acceptable. *Id.* at 661.

FDC is not the inflexible barrier to rate competition that the Department of Justice suggests. Although the Commission requires full cost data in support of all rate filings, its order expressly contemplates departures from full costs when the carrier can justify them on the ground of efficiency or other public interest grounds. *Id.* at 663, 666, 668. Competitive necessity is one basis for departing from full costs. *Id.* at 654-55. The standard for judging competitive necessity is essentially the same standard the Second Circuit approved in *American Tel. & Tel. Co. v. FCC*, 449 F.2d 439, 449-50 (2d Cir. 1971).

A persuasive argument for FDC pricing rather than LRIC was made in comments filed by the Department of Justice in 1970 in the *Specialized Common Carrier Services* proceeding, Docket No. 18,920. (FCC Br., Attachment B) These comments were incorporated in Docket No. 18,128. Responding to AT&T's claim that it should be allowed to compete in the private line market by offering rates based on long-run incremental costs, the Department stated that:

1. Such costs are "too difficult to determine objectively, accurately or promptly."

2. The difficulty of determining the real costs would create the danger that AT&T would drive out or discourage new entrants "even if its cost is higher."

3. Low rates are not the only goal of communications policy, but most be considered along with innovation in services and improvements in quality that might come with new entry.

4. The Commission "should judge rates as predatory by means of a standard based on long run fully distributed costs."

5. "It is certainly true that the determination of 'fully distributed' or 'long-run average' costs involves estimates and somewhat arbitrary allocation formulas. Nevertheless, this standard is considerably more susceptible to regulatory control, and leaves less discretion in the regulated carrier, than in incremental cost approach."

The Commission rejected LRIC after considering the Department's current arguments in the light of its 1970 representations, together with the other relevant factors and policies. We cannot say that the Commission's conclusion, reached in the exercise of its discretion, was arbitrary or capricious and therefore we will not disturb it.[13]

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[13] The theoretical benefits of LRIC pricing described in Judge Wilkey's separate opinion were also explored by the Supreme Court in American Commercial Lines v. Louisville & Nashville R. Co., 392 U.S. 571 (1968). As the Court stated there, the courts are "not particularly suited to pass on the merits of the[se] economic arguments. . . ." *Id.* at 586 n.16. In light of Judge Wilkey's separate opinion, however, one or two observations may be in order.

LRIC pricing has been developed only recently, primarily as a theoretical construct. To the extent it has been applied to regulated industries, it apparently has been confined to the monopolized markets for which it was originally devised. *See* Docket 18,128, 61 F.C.C.2d at 622 (quoting Recommended Decision). Indeed, considerable controversy remains as to whether LRIC pricing is either appropriate or capable of being administered in the far more complex and less well-

B. *Unlawfulness of Certain Specific Rates*

In its First Order on Reconsideration the Commission declared unlawful the revisions in the following rates and rate elements within the private line service categories: (1) increases in rates for teletypewriter station equipment, effective November 1, 1968; (2) changes in the TELPAK telegraph/telephone equivalency ratio, effective September 1, 1968 and February 1, 1970; and (3) several elements of the rates in the private line telephone, private line telegraph, and TELPAK offerings,

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understood regulatory environment of a mixed monopoly and competitive enterprise. *Id.* at 623-26. Thus, while the Commission's Opinion demonstrates a general sensitivity to the theoretical benefits of marginal cost pricing (of which LRIC is one species), it is tempered by the recognition that many of the conditions favoring such pricing in a mixed monopoly/competitive environment have not yet been clearly demonstrated. *Id.*

In his separate opinion, Judge Wilkey nevertheless argues that the Commission's action cannot be upheld because it relies on "some fundamentally unsound economics." Opinion of Wilkey, J., at 2. As we understand his opinion, Judge Wilkey maintains that the Commission irrationally assumed that LRIC pricing automatically results in the addition of extra, fixed costs on monopoly customers, and that therefore the Commission rejected LRIC pricing without fairly considering its pro-competitive advantage. *Id.* at 8. We would not agree. The passages from the Commission's Opinion cited by Judge Wilkey can fairly be read simply as a recognition that when common or joint unattributable costs are carried solely by a company's monopoly customers, those customers are called upon to carry a more onerous burden than all others. This, in the Commission's terminology, may result in "cross-subsidization," *see, e.g.*, 61 F.C.C.2d at 652, giving monopolists capable of loading their fixed costs entirely on monopoly customers a special advantage when they enter competitive markets. So read, in our view it was a matter for the Commission, in its discretion, to determine whether this aspect of LRIC pricing in mixed economic environments poses a serious drawback.

effective May 4, 1972. The Commission's basic ground for this ruling was that AT&T had relied on long-run incremental cost studies to justify the increases. 64 F.C.C.2d at 989-91.

We have concluded that the FCC failed to take a sufficiently careful look at the problem presented, and failed to engage in reasoned decisionmaking with respect to this issue.[14] Accordingly we vacate the Commission's declaration of unlawfulness and remand the issue for further consideration. Stripped to its essentials, the Commission's reasoning is that because the increases were supported by long-run incremental cost studies, AT&T failed to meet its burden of justifying the rates. The Order contains no examination of the voluminous evidence of record, no analysis of the substance of the underlying cost studies, and no discussion of the rate element increases on their merits. This treatment cannot qualify as reasoned decisionmaking.

AT&T has pointed to certain record evidence, none of which is mentioned or discussed by the Commission, which substantiates its position. For example, the installation charge for new private line service terminals was being increased from $20.00 to $50.00.[15] The actual labor costs were shown to be $250.00.[16] Thus, with revenues of $50.00 and costs of $250.00, there seems to be no basis for the Commission's finding that the installation charge increases were not justified. Likewise, it would appear that the 1972 $5.00 increase in the monthly charge for private line telephone service terminals[17]

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[14] *See* Greater Boston Television Corp. v. FCC, *supra*.

[15] J.A. 932.

[16] J.A. 924.

[17] A service terminal is used to terminate private line channels at the telephone company central office serving the customer's premises.

would be justified. This increase would raise the average channel charge for short-haul distances of up to 25 miles to approximately $5.50 per mile, still less than the costs of $6.40. *See* Brief for Petitioner AT&T at 34-35.

A further consideration points to irrationality. The Commission concluded that LRIC data was insufficient to justify these rate increases, requiring instead that FDC data be supplied. However, LRIC understates costs, i.e., LRIC costs are lower than FDC costs because LRIC do not contain a portion of the overhead, as FDC do. If a rate increase is necessary to cover LRIC (which is what AT&T sought), it follows *a fortiori* that such an increase would be necessary to cover FDC.

Because of these considerations the Commission is directed to reconsider these rate increase requests in light of the points raised by petitioner AT&T. The Commission may of course require AT&T to furnish cost studies based on the appropriate FDC methodology prior to this reconsideration.

C. *Past Rate Levels for Private Line Services*

With respect to the rate levels for the private line service categories (other than TELPAK) the Commission, in its Final Decision, declared that: "Past levels of return for these services have generally been unlawfully low, although in some years the level of return for some services could be considered to have approached the zone of reasonableness." 61 F.C.C.2d at 652. Because the Commission reached this conclusion solely on the basis of the retroactive application of its newly-established FDC standard[18] without also (1) considering the non-cost factors which it takes into account, in determining the reasonableness of rate levels, or (2) explaining its failure to consider these factors, this action must be vacated and

[18] 61 F.C.C.2d at 651-52.

this issue remanded to the Commission for further consideration. Reasoned decisionmaking is again absent. *See Greater Boston Television Corp. v. FCC*, *supra*, 143 U.S. App. D.C. at 393-94, 444 F.2d at 851-52. To illustrate our conclusion, we point out the following: the Commission found that the return level for television program transmission service had been "unlawfully low" since 1971[19] without considering (1) its own requirement of reduced rates for educational television transmission;[20] (2) its own refusal to accept tariff filings during 1972-73 increasing commercial television rates;[21] and (3) its own sanction in 1973 of a stipulation freezing television rates for at least a two-year period.[22] Likewise, the Commission's finding that the rate level for the audio/radio program transmission category was too low in the 1967-75 period (61 F.C.C.2d at 651-52) does not take into consideration the stipulation, approved by the Administrative Law Judge in Docket 18128, preventing rate changes in that category for at least two years. FCC 70M-941 (1970) (J.A. 344). And it fails to factor in the Commission's requirement that reduced rates for radio transmission service be offered to the Corporation for Public Broadcasting and National Public Radio. *See, e.g.*, 31 F.C.C.2d 496 (1971).[23]

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[19] 61 F.C.C.2d at 652.

[20] *Free or Reduced Rate Interconnection Service for Non-Commercial Educational Broadcasting*, 31 F.C.C.2d 496 (1971).

[21] See American Telephone & Telegraph Co. v. FCC, 487 F.2d 865 (2d Cir. 1973).

[22] 44 F.C.C.2d 525, 527-29 (1973).

[23] Other examples appear in Brief for Petitioner AT&T at 43. As far as the court is able to ascertain, no party (including the Commission), either in a brief or at oral argument, has attempted to defend the agency's action with respect to this issue.

Consequently, this portion of the Commission's decision is vacated and the issue is remanded for further consideration.

D. *Separation of Bureau Staff*

Several petitioners have contended that the Commission's procedures were unfair because of the multiple roles of the Common Carrier Bureau staff in presenting evidence, drafting the Recommended Decision, and advising the Commission on its Final Decision. We observe with approval that the Commission in 1974 amended its rules to provide for a separated trial staff in proceedings such as those in this case, although the new rule is not being applied to proceedings already under way, including this one, due to the disruption and delay this would cause.[24]

We note that this same argument[25] was made at the beginning of these TELPAK proceedings but this court was not persuaded.[26] We decline to consider the point anew.[27]

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[24] *Restricted Rulemaking Proceedings*, 47 F.C.C.2d 1183, 1184 n.9 (1974).

[25] *See* Joint and Several Brief for Aeronautical Radio, Inc., Air Transport Ass'n of America, American Airlines, Inc. and Eastern Air Lines, Inc. filed Sept. 3, 1965 in D.C. Cir. Docket No. 19,466, at 23-29.

[26] American Trucking Associations, Inc. v. FCC, 126 U.S. App. D.C. 236, 248, 377 F.2d 121, 133 (1966), *cert. denied*, 386 U.S. 943 (1967) ("Examination of this record satisfies us that the Commission complied with all procedural requirements").

[27] Other courts have addressed the underlying issue. *See* Wilson & Co. v. United States, 335 F.2d 788, 796-97 (7th Cir. 1964); *remanded for consent settlement*, 382 U.S. 454 (1966); American Tel. & Tel. Co. v. FCC, 449 F.2d 439, 453-55 (2d Cir. 1971).

E. *Failure to Prescribe Telpak Rates*

Petitioner Aeronautical Radio, Inc. contends that the Commission unlawfully failed to prescribe rates for TELPAK service under 47 U.S.C. § 205(a). That section empowers the Commission to prescribe rates if, after full opportunity for a hearing, the Commission is of the view that the rates set by the carrier are unlawful. Here the Commission has made no finding that TELPAK is unlawful and has, indeed, stated that the TELPAK rate levels "appear to be within the zone of reasonableness." 61 F.C.C.2d at 659. In any event, we are of the view that, considering the circumstances of this case, the Commission has not abused its discretion in this matter and therefore we will not interfere.

F. *Refusal to Reject Transmittal No. 12714*

1. 47 U.S.C. § 214(a)

Several petitioners say that the Commission erroneously failed to reject Transmittal No. 12714 when that filing, which would eliminate TELPAK, was not accompanied by the requisite authority under section 214(a) of the Communications Act (47 U.S.C. § 214(a) (1976)). Section 214(a) requires that

> No carrier shall discontinue, reduce, or impair service to a community or part of a community, unless and until there shall first have been obtained from the Commission a certificate that neither the present nor future public convenience and necessity will be adversely affected thereby. . . .

AT&T did not seek, and the FCC did not purport to grant, a § 214(a) certificate in this case.

We hold that § 214(a) did not apply in this case. The termination of the TELPAK "service" did not in fact discontinue, reduce, or impair any service at all; all it did was eliminate a rate dicount, thereby effectuat-

ing a rate increase. All the services which had been offered under the TELPAK tariff were still available thereafter from AT&T pursuant to other tariffs or other sections of the same tariff; only the rates differed. See 64 F.C.C.2d at 965. *See also American Tel. & Tel. Co. v. FCC*, 449 F.2d 439, 446 n.5 (2d Cir. 1971) ("[T]he customer uses precisely the same physical facilities whether his service is ordinary private-line, Telpak, or shared Telpak.") Were we to accept petitioner's view, virtually every rate increase might be argued to be a discontinuance of "service" requiring a prior finding of convenience and necessity by the Commission. The attendant burdens would be enormous. Likewise, such a construction would be at odds with the scheme of carrier-initiated tariff filings which is at the heart of the Communications Act. 47 U.S.C. §§ 203-205 (1976).

2. 47 C.F.R. § 61.38

Section 61.38 of the Commission's rules, 47 C.F.R. § 61.38 (1978), requires certain supporting economic data to be filed with tariff changes. Such data must include a cost of service study for all elements of cost for the most recent 12-month period and a projection of costs for a three-year period beginning at the date of the filing of the tariff matter. *Id.* § 61.38(a)(2)(i). Also, the carrier must submit estimates of the effects of the tariff change on the carrier's traffic and revenues for the prior year and the succeeding three years. *Id.* § 61.38 (a)(2)(ii). Finally, for tariff changes embodying rate increases of the magnitude proposed by AT&T, all cost, marketing, and other data relied on to justify the change must be filed. *Id.* § 61.38(d).

In this case the Commission held that, even if § 61.38 were applicable, it would exercise its discretion and waive the rule in this case. We hold first that the rule was applicable, and second, that it was an abuse of discretion to waive it.

a. Section 61.38 was applicable.

The Commission argues that, because the single-channel rates which will be charged after the elimination of TELPAK are the same rates in effect before that elimination, no tariff change has been effected and § 61.38 does not apply. However, our view is that the elimination of TELPAK constituted a rate increase, and that therefore the rule was applicable. The following example illustrates our conclusion. If the single-channel rate was $1/month, and the TELPAK C rate for 60 channels was $40/month, the elimination of TELPAK would cause the price for 60 channels to go from $40/month to $60/month. This would constitute a rate increase of $20/month. *What is the relevant product?* In our illustration, the relevant product is 60 channels per month, not 1 channel per month. The price *for the relevant product* has gone up $20/month.

b. It was an abuse of discretion to waive § 61.38.

It is true that when AT&T filed Transmittal No. 12714 eliminating TELPAK, it was under Commission order to do so. However, that mandate was rescinded in the First Order on Reconsideration announced June 1, 1977 and thus would not justify the Commission's subsequent refusal to reject the tariff filing.

The purpose of § 61.38 is not only to provide the Commission with the information it needs to appraise tariff filings, but also to provide customers, competitors, and the public with that information so that they may intelligently participate in the Commission proceedings.[28] *See*

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[28] Among other things, public comments are useful in suggesting which tariff filings might be particularly considered for suspension and/or investigation, since there are so

Amendment of Part 61, 25 F.C.C.2d 957, 970-71 (1970); *Part O—Commission Organization*, 57 F.C.C.2d 1122, 1123 (1976); *Amendment of Parts O, 1 and 61*, 62 F.C.C.2d 474, 476 (1976).[29] Waiver of the rule deprived the public of this opportunity to participate.

If the tariff filing in this case were a less significant one, the Commission's action, with its attendant effect on the public's ability to participate, might nonetheless be justifiable. However, this filing was to have a massive effect: a total increase in charges of approximately $100 million per year was to take place.[30] Certainly the affected customers should have had the relevant data and an opportunity to comment on proposed increases of this magnitude.

The Commission responds that it relied on the presence of data filed in another docket, Docket 20814, in determining that compliance with § 61.38 would be unnecessary. Unfortunately, the Commission has stated elsewhere that Docket 20814 "has no relevance" to the termination of TELPAK services. 64 F.C.C.2d 959, 967 (1977). Although this conclusion is not binding on us, we are convinced that the pendency of the Docket 20814 proceeding, with the data submitted therein, is not sufficient to justify the waiver of § 61.38 in this case. In Docket 20814 the Commission was investigating only

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many tariff filings each year that the FCC cannot review each one as carefully as some parties might desire.

[29] *Cf.* American Tel. & Tel. Co. v. FCC, 503 F.2d 612, 614 (2d Cir. 1974), where the court stated that the purpose of the waiting period before which a tariff can go into effect is to "give the public the opportunity to review the tariff and to make any pertinent comments. It is further intended to provide the FCC time to study the tariff as well as any comments received from the public."

[30] Brief for Petitioner General Electric Co. at 46.

Series 2000 and 3000 (voice and data-grade service), not Series 1000 or 4000 (telegraph and telephoto);[21] additionally, in Docket 20814 the Commission was looking only at the general rate of return for all customers; the specific rate of return for TELPAK-type customers was not being separately considered.

Thus, we hold that the Commission abused its discretion in waiving Rule 61.38 in this case and consequently erred in refusing to reject Transmittal No. 12714. However, we will not require that the Transmittal be rejected immediately. Such a requirement would have the effect of reinstituting TELPAK for all customers, new and old, but this time subject to sharing and unlimited resale. AT&T in good faith has attempted to avoid such a result and we think it would be inequitable to allow circumstances to dictate a contrary result at this time. Additionally, with regard to the injunction which this court entered July 21, 1977, we are concerned that abrupt termination of that injunction would force current TELPAK customers, with little or no warning, to make important decisions regarding their future telecommunications needs. Consequently, in the interest of justice and equity and to allow for an orderly readjustment of relationships between the parties, we order (1) that the Commission reject Transmittal No. 12714, but the Commission may delay such action for as much as 120 days from the date this opinion is filed, and (2) that the injunction entered in this case on July 21, 1977 be continued in effect until the Commission rejects Transmittal No. 12714. This maximum 120-day period (shortened if the Commission desires) should be sufficient to allow AT&T time to assemble the appropriate § 61.38 data and submit them in connection with a new

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[21] Former TELPAK customers would be switching over to all four of these services.

tariff transmittal terminating TELPAK. The 120-day period is intended to include the 90-day period for notice of 47 C.F.R. § 61.58(b).[22] The court retains the necessary jurisdiction to accomplish the foregoing.

Judgment in accordance with this opinion.

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[22] See 42 Fed. Reg. 12175 (1977). Naturally, AT&T is not required to terminate TELPAK; it is merely permitted to do so.

WILKEY, *Circuit Judge*, dissenting in part: While I concur in the bulk of the majority's opinion, I believe my colleagues too hastily accept one part of the Commission's ratemaking prescriptions in Docket No. 18,128, *in re* American Telephone & Telegraph Co.,[1] which I find arbitrary and capricious. The FCC's order in Docket No. 18,128 prescribes the use of Fully Distributed Costs (FDC) as the required standard for calculating rates both in monopoly markets and in competitive markets. As a ceiling for rates in *monopoly* markets, it is reasonable to use a standard based on FDC as a means to prevent monopoly pricing. But for the entirely *different* task of setting a rate floor in *competitive* markets, FDC pricing should not be hastily approved without scrutiny of its economic rationality in this context. In its choice of FDC pricing in this case, the FCC has shown a serious misunderstanding of the nature of pricing decisions in competitive markets. This misunderstanding has led the Commission to adopt FDC pricing without rational consideration of its anticompetitive effects in a competitive market, and without showing that this standard is rationally related to the Commission's legitimate regulatory purposes.

I must therefore dissent from Part II A of the majority opinion insofar as it upholds FDC as a standard for establishing rates in competitive markets. For the same reason, I must also concur separately in the majority's Part II C; while I agree in vacating and remanding the Commission's findings as to specific rates, I would not permit the Commission on remand to evaluate specific rates by a standard that embraces FDC for minimum pricing in competitive markets.

As the majority opinion states, our task in reviewing challenged Commission actions of this sort is limited to

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[1] 61 F.C.C. 2d 587 (1976).

keeping the Commission within proper bounds for the reasonable exercise of its discretion. While agencies do have broad discretion in ratemaking proceedings,[2] we must also keep in mind that "the width of administrative authority must be measured in part by the purposes for which it was conferred . . . ." [3] The rationality of the Commission's prescribed FDC costing methodology is challenged *both* by petitioner American Telephone and Telegraph Co. (AT&T),[4] *and* by the United States Department of Justice in its role as a statutory respondent.[5] The significance of the fact that the Antitrust Division and AT&T—not usually found as allies in legal contests—are in thorough agreement that the Commission has embraced some fundamentally unsound economics, as the underpinning of its whole decision on this point, should not be minimized.

To evaluate the rationality of the Commission's prescribed FDC pricing for competitive markets, we must therefore first define the legitimate purposes of FCC rate regulation. The Commission derives its authority to regulate rates for communication services from Title II of the Communications Act of 1934. The Act sets broad standards requiring that rates be "just and reasonable" [6] and prohibiting "unjust or unreasonable discrimination" and "undue or unreasonable preference or advantage." [7] In monopolized markets FCC rate regula-

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[2] *See Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968), *cited in* Maj. Op. at 13.

[3] *Id.* (citations omitted).

[4] *See* Brief for Petitioner AT&T at 13, 44-45; Reply Brief for Petitioner AT&T at 16-23.

[5] *See* Brief for Respondent United States of America at 32-40.

[6] 47 U.S.C. § 201(b) (1976).

[7] *Id.* § 202(a).

tion serves the purpose of limiting carriers to just and reasonable rates in order to prevent monopoly pricing. In competitive markets, on the other hand, just and reasonable prices are normally maintained through the effect of free competition—indeed, regulation of "just and reasonable" rates is essentially a replacement or surrogate for the effects of free competition.[8]

As a general matter, then, competitive markets do not need the constant rate regulation that is necessary to ensure just and reasonable prices in monopoly markets. But a potential does exist for unjust or discriminatory prices to arise in non-monopoly markets, in a manner that can warrant rate regulation. When a firm operates in a regulated market where it enjoys a monopoly, and also operates in a separate market where it faces competitors, there is a danger that the firm may reduce its rates in the competitive market below the level that would fully compensate for its costs of operation in that market. The use of this technique to drive competitors out of the market or to keep potential competitors out is often called "predatory pricing."[9] If a regulated firm such as AT&T engaged in predatory pricing, its losses or below-normal profits in the low-price competitive market could be offset by increasing its profits in the firm's monopoly markets. Even if the firm's overall rate of return were within just and reasonable limits set by the regulatory agency, the customers in the monopolized market could find themselves paying higher than reasonable rates in order to finance the firm's predatory pricing activities in the competitive market. An unjust and discriminatory system of "cross-subsidies"

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[8] *See, e.g.*, I A. KAHN, THE ECONOMICS OF REGULATION 20 (1970); *In re American Tel. & Tel. Co.*, 61 F.C.C. 2d at 77 (quoting Recommended Decision).

[9] *See, e.g.*, F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 273-74 (1970).

could thus arise, with the monopoly market customers paying more than their fair share in order to subsidize the firm's activities in competitive markets.

The FCC focuses on this danger to justify its regulation of minimum rates for AT&T in the competitive market of private line services. As its basic regulatory objective here, the FCC seeks costing and pricing standards that will allow AT&T to compete in a new and competitive market "without allowing it to use revenues from captive monopoly markets as a source for cross-subsidies." [10] The existence of cross-subsidies would violate the Commission's goal of equitable and nondiscriminatory treatment of all service users,[11] and would permit AT&T to exploit resources acquired through its privileged monopoly status in other markets to gain an unfair advantage against other firms in the competitive market.[12]

There is no question that preventing cross-subsidies is a legitimate regulatory purpose of the FCC; *the issue is whether FDC pricing is a means rationally related to this end*, or whether Long Run Incremental Cost (LRIC) pricing will more surely achieve this regulatory end. As a preliminary matter, it is important to note that prevention of cross-subsidies does not justify any and all standards for minimum rates. The establishment of exorbitantly high minimum rates would certainly prevent cross-subsidies; but it would also stifle competition and seriously harm AT&T's consumers in the competitive market, who have a strong interest in low prices. This indicates that the goal of preventing cross-subsidization exists in tension with the goal of promoting competition. The FCC has discretion to choose within a range of minimum rate standards that are rationally related to

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[10] Brief for FCC at 48.

[11] *See In re American Tel. & Tel. Co.*, 61 F.C.C. 2d at 612.

[12] *See id.* at 616.

preventing cross-subsidization. *But if the Commission sets minimum rates at a level higher than is rationally related to the goal of preventing cross-subsidies, then the Commission impairs competition without rational justification, and is subject to judicial reversal for arbitrary and capricious action.* This standard of review is nothing more than a specific application of the general principle quoted above, that the agency's authority is to be measured by its purposes.

To decide what minimum level of rates is reasonable in a competitive market, the starting point is the ascertainment of the firm's costs for providing particular services in that market.[13] Although it acknowledges that cost is not the sole criterion of reasonableness, the FCC requires as a first step that rate levels be justified in terms of the cost of providing a particular service.[14] Controversy arises from the various methods of determining costs, and from the fact that certain costs may be relevant for one purpose but not for another. The Commission maintains that in order to prevent cross-subsidization, rate levels must be calculated in relation to Fully Distributed Costs. AT&T's proposal to calculate rates in competitive markets based on long run incremental costs, the Commission concludes, is inadequate to prevent cross-subsidies.

FDC and LRIC are alternative methodologies for calculating the costs that relate to a particular service. Under either methodology the Commission calculates the relevant costs, and then compares the cost figures with the rate level for that service. If the rates for a particular service are either higher or lower than the relevant cost figures, then the Commission can disapprove them as not cost-justified. In the present case the Commission aims to discover whether rates are sufficiently

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[13] *See id.* at 618-19 (quoting Recommended Decision).

[14] *See id.* at 607.

high to compensate for all relevant costs; if they are not, then the low-rate service is presumably being cross-subsidized by revenues from other services. A common aspect of both FDC and LRIC as used in this case is that a cost of capital figure is included in costs, so that when rates equal costs for a particular service, the utility is earning a rate of return equal to the cost of capital figure, in other words, a "normal" profit.

The difference between FDC and LRIC arises from the fact that some costs of any firm are inherently unattributable to any particular service category. Firms such as AT&T provide monopoly and competitive services through an integrated network with extensive use of common facilities, management, and marketing resources.[15] These common or joint costs[16] cannot be said to be related in an ascertainable way to any particular service category; rather they relate to all service categories indistinguishably. In terms of the present case, *these unattributable fixed overhead costs do not increase when AT&T decides to start offering private line services as a new category of service, and they do not decrease when AT&T decides to discontinue private line services.*

The LRIC method assigns to each service category only those costs attributable to that category, that is, *only the long-run increment to pre-existing firm costs that arises when the service category is added to existing service categories.* This increment includes the variable costs incurred in providing the service plus any additional fixed overhead costs required in the long run due to the addition of the new service. *But the increment does not include common or joint costs that existed before the new service was offered and would exist if the*

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[15] *See id.* at 619 (quoting Recommended Decision).

[16] *See* I A. KAHN, *supra* note 8, at 77-79.

service were discontinued. Under LRIC, such unattributable costs are not assigned to any individual service category.

Under FDC pricing, on the other hand, these unattributable costs are assigned by a formula to individual service categories. The formula attempts to allocate common and joint costs among the services according to the proportionate use each service makes of those facilities. Rate levels are then computed to cover the attributable costs of the service category plus its calculated share of common unattributable costs. There is of course no "right" way to assign unattributable costs—seven different formulas were considered by the Commission in this proceeding, each having various advantages and disadvantages. But FDC pricing starts from the premise that all costs must be assigned to some service category, and proceeds to assign them by a selected formula that is consistent, even if inevitably arbitrary. When calculating maximum allowable rate levels for a regulated firm, some formula must be chosen for allocating common and joint costs; otherwise such costs would be left out of the firm's rate base, and its total revenue from all service categories would fail to cover its unattributable costs.[17]

There is no serious doubt that FDC pricing is appropriate for establishing maximum allowable rate levels; for this purpose an FDC standard ensures that the firm will recover all costs while not making more than a normal allowable profit. *The controversial issue is whether FDC is also reasonable for the purpose of setting minimum rates in competitive markets.*

In its decision choosing FDC pricing for AT&T's competitive markets, *the FCC relies on an assumption*, which

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[17] *See In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 619-26.

runs either tacitly or explicitly throughout its opinion, that unless competitive service customers pay for the fully distributed costs of their services, monopoly service customers will be subsidizing the competitive service market. The Commission's rejection of LRIC pricing flows from a belief that any pricing system based on marginal or incremental costs, omitting common and joint costs, will lead to cross-subsidies. This fundamental hostility toward marginal cost pricing is found most explicitly in the words of the Recommended Decision, quoted in the FCC's opinion, that it "has not been conclusively shown that marginal cost pricing can be applied to one service without a subsidy from some other service or source." [18]

The Commission also makes this assumption explicit when, in evaluating AT&T's rate structure, it reasons that the failure of AT&T to generate revenues for its TELPAK and private line services sufficient to cover fully distributed costs means that the rate structure is maintained through cross-subsidization.[19] The Commission states that "our solution in this proceeding is designed to achieve return levels for these services whereby the earnings for each competitive service can sustain that service's viability without relying on cross-subsidization." [20] The same assumption is stated clearly in the additional concurring views of Chairman Wiley, that under an incremental cost methodology, "AT&T would be free to subsidize private line service offerings at the expense of the telephone ratepayer." [21]

The FCC position rests on the notion that unattributable common and joint costs must be borne proportion-

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[18] *Id.* at 624.

[19] *See id.* at 652.

[20] *Id.*

[21] *Id.* at 669.

ately by monopoly and competitive service customers. An LRIC standard for minimum pricing in competitive markets, of course, does not require competitive service customers to bear any common or joint costs, but only the incremental costs the firm incurs in serving them. As stated in its appellate brief, the FCC position maintains that LRIC pricing "should not be applied selectively to AT&T's competitive services in a manner that would burden monopoly service customers with all residual costs." [22]

The central point in this case is that, contrary to the FCC's assumption, the long run incremental cost standard when properly applied does NOT and can NOT result in a "subsidy" of competitive service customers by monopoly service customers. This point is apparent from an application of common sense to the facts of this case, and it is borne out by the analysis of economists with much greater consensus than is commonly seen in that profession. Unfortunately the majority opinion simply defers to the contrary assumption of the FCC without analyzing its rationality.[22a] I believe that upon scrutiny the FCC's assumption collapses, and leaves the Commission's decision without rational support.

We begin from the fact that the competitive private line services market is a new market for AT&T, and that *AT&T's success in the market depends on its ability to set prices as low as its competitors.* It follows from the nature of a competitive market that if AT&T raises

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[22] Brief for FCC at 53.

[22a] ". . . it was a matter for the Commission, in its discretion, to determine whether this aspect of LRIC pricing in mixed economic environments poses a serious drawback." Maj. op. at 17 n.13. Contrary to the majority's attempted evasion of hard economic analysis, the FCC's assumption, as evidenced in the quoted passages above and throughout the FCC opinion, is the key to the economic errors on which the decision is founded.

prices it will tend to lose customers. Private line customers might either go to a competing supplier or set up their own microwave communications system. The FCC mentions that AT&T faced competition from terrestrial and satellite carriers in the intercity private line market, and from the authorization of private microwave systems.[23] The higher AT&T is forced to maintain its prices, the greater will be its loss of customers to these alternatives.

By contrast, AT&T does not face the same pressures to lower prices in its monopoly service markets. By definition, these markets do not present AT&T with competitors bidding for the patronage of various AT&T customers. Thus AT&T can keep its prices at higher levels in monopoly markets with less tendency to lose customers.

With these facts in mind, it becomes *critical to recognize the additional fact that AT&T's common or joint unattributable costs will exist whether or not it offers services in the competitive market.* These costs existed and were borne by AT&T's monopoly service customers before AT&T entered the competitive market, and would again be borne fully by them if AT&T were forced out of the competitive market.

When AT&T considers whether to enter or to expand sales in a competitive market, the old monopoly service customers stand to benefit so long as the new customers bear *any* part of the common or joint costs. To determine whether monopoly customers will benefit from the firm's operations in the competitive market, one need only calculate whether the revenues from the new competitive market operations pay fully for the incremental or additional costs the firm incurs for these operations. If revenues cover these costs (including cost of capital) as measured by LRIC or any similar variant of marginal

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[23] *See In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 610.

cost measurement, *then ANY additional revenue earned above the LRIC level is a bonus for the monopoly customers.* Any revenue above the LRIC level can be used to cover part of the common or joint costs of the overall firm operations, thus reducing the amount of common or joint costs borne by monopoly service customers and allowing a rate reduction for them. At any rate level above LRIC in the competitive market, monopoly customers are better off than they would be if the firm were not making such sales in the competitive market. Only if services are offered in the competitive market at less than LRIC do the monopoly service customers have to pay a higher rate than they would absent operations in the competitive market.

To say that LRIC forces all the joint or common costs onto monopoly service customers ignores the fact that they were burdened with the full measure of these costs in the first place, and the company's expansion into the competitive market at rates above LRIC reduces the absolute amount of that burden. If monopoly service customers are not burdened more severely under LRIC than they were before AT&T entered the competitive market, then there is no reasonable argument that monopoly service customers are providing a "cross-subsidy."

Of course the monopoly service customers would be even better off if the firm could raise rates for its competitive market services to the FDC level rather than just to the LRIC level—but only if the increase in rates does not produce a serious drop in sales. If demand is elastic, the increase in rates will actually produce a *decrease* in revenues.[24] The exact degree of elasticity is difficult to measure, but the general tendency is for more competitive markets to have more elastic demand. Indeed, one economist states that "the most powerful determinant of the elasticity of demand for the services of any

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[24] *See generally* P. SAMUELSON, ECONOMICS 381-83 (1976).

single company is the presence or absence of competing suppliers." [25]

It is primarily a business decision, to be left to the judgment of the firm, what level of rates will produce the highest revenues. Neither an agency nor a court can predict the revenue effects of each rate increase or decrease. *But so long as rates are above LRIC, agencies and courts can rest assured that monopoly service customers are NOT subsidizing the firm's operations in the competitive market;* those customers pay no more under such circumstances than they would if the firm were not in the competitive market. How much above LRIC the firm can set its prices and still remain competitive and maximize revenues, is a decision that can safely be left to private business judgment. *In its pursuit of maximum allowable profit, the firm has ample incentive to set its rates as far above LRIC as the market will bear.* If the firm chooses not to set its rates significantly above LRIC, the logical explanation is that competitive pressures prevent higher rates. *The role of agencies and courts is only to keep prices above predatory pricing levels, to prevent cross-subsidies, and to keep rates below monopoly pricing levels.* Within these bounds, pricing discretion should rest with the firm:

> As long as a public utility company can take business away from its competitors at rates that cover long-run incremental costs for that business, both efficiency in the performance of the public utility function and the interest of all rate-payers recommend its being permitted to do so, all other things being equal.[26]

This common sense analysis is exactly the conclusion drawn by economists. It is the nearly universal view

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[25] I A. KAHN, *supra* note 8, at 159 (emphasis in original).

[26] *Id.* at 162.

among economists that marginal or incremental costs are more relevant to competitive market pricing than are full costs.[27] Economists generally agree that economic efficiency is served when prices approximate marginal costs.[28]

For example, Alfred E. Kahn (currently head of the Council on Wage and Price Stability), states explicitly that when prices for elastic demand customers (as in a competitive market) are held no lower than the full additional costs of taking on that additional business, and prices for inelastic demand customers (as in a monopoly market) are held no higher than average total cost, *then there can be no internal subsidization.*[29] *The*

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[27] *See generally id.* at 63-86. *See also In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 670-71 (Hooks, Comm'r, dissenting) (citing authorities).

[28] Alchian says: "The general rule is simple: To minimize the costs of any specified amount of X, produce it with the lowest marginal costs. . . . In brief, producers should produce amounts that equate their marginal costs (or comes as near as possible to equating them). That will result in no waste—that is, in minimum cost." A. ALCHIAN, EXCHANGE AND PRODUCTION 172-77 (1977).

Samuelson says: "Our analysis has demonstrated the following remarkable truth: Only when prices of goods are equal to Marginal Costs is the economy squeezing from its scarce resources and limited technical knowledge the *maximum* of outputs. Only when each source of industry output has had its rising MC [marginal cost] equated to *any* other source's MC—as will be the case when each MC has been set equal to the common P [price]—can the industry be producing its total Q [quantity] at *minimum Total Cost.* Only then will society be out *on* its production-possibility frontier and not *inefficiently inside* the frontier. This equal-marginal-cost dictum is as applicable to a communist, socialist, or fascist society as to a capitalistic society." P. SAMUELSON, *supra* note 24, at 462 (emphasis in original).

[29] These are the rules that most authorities have adopted, and with which we concur. One implies the other; as long as

LRIC pricing method is designed precisely to determine the full additional costs of additional business in a competitive market. If properly applied, it is sufficient to prevent cross-subsidies.

The LRIC method is a specific application, in modified form, of marginal cost pricing. Samuelson describes the rationale, from an individual firm's perspective, for making pricing decisions according to extra or marginal costs, while viewing sunk costs—such as the common and joint costs of AT&T—as "bygones":

> Let bygones be bygones. Don't look backward. Don't moan about your sunk costs. Look forward. Make a hard-headed calculation of the *extra* costs you'll incur by any decision and weigh these against its *extra* advantages. Cancel out all the good things and bad things *that will go on anyway*, whether you make an affirmative or negative decision on the point under consideration.[30]

The LRIC method is designed to perform exactly this sort of calculation, to compare additional revenues—*i.e.*, rates for competitive services—with the incremental costs of providing those services. The FDC method, by contrast, would force AT&T to focus on the "bygones" while its competitors are free to employ a more rational form of competitive pricing.

Kahn concludes that long run marginal costs are the proper starting point for assessing the validity of com-

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the favored customers pay their full additional costs, the others cannot on this account be led to pay more than the costs of serving them in the absence of discrimination. And both together imply the condition that discrimination be permitted only as long as it imposes no burden on the customers being discriminated against. Such a rule would prohibit *internal subsidization.*" I A. KAHN, *supra* note 8, at 142–43 (emphasis in original). *See also id.* at 142 n.37, and sources cited therein.

[30] P. SAMUELSON, *supra* note 24, at 498 (emphasis in original).

petitive rate reductions by regulated companies in competitive markets.[31] Society has an interest in communications services being provided at lowest possible cost, and economic efficiency considerations require "that no business be turned away that covers the cost to society of providing that service."[32] LRIC is calculated to achieve precisely this efficiency, FDC is not. It is important to note that Kahn does envision limited circumstances in which long run marginal costing would not be appropriate,[33] but the Commission did not even consider whether such special circumstances might make this case an exception to the general desirability of marginal or incremental cost pricing.

The Commission did not directly attack the desirability of marginal cost pricing. At some points in its decision, the Commission appeared to concede the theoretical merits of marginal cost pricing,[34] while at other points it implied that marginal cost pricing would necessarily lead to cross-subsidies. Rather than attack the marginal cost pricing concept directly, the Commission objected that LRIC is not truly a marginal cost technique,[35] and it is true that LRIC does not price according to the cost of producing the marginal single unit of service. But in fact LRIC, by focusing on long-run increments to joint and common costs as well as the additional variable costs of producing the extra units, sets a cost figure that is likely to be *higher* than pure marginal costs.[36] Thus LRIC leaves even less chance of

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[31] *See* I A. KAHN, *supra* note 8, at 159-75.

[32] *Id.* at 160-61.

[33] *See id.* at 166-70.

[34] *See, e.g., In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 636 n.80.

[35] *See id.* at 621-24.

[36] *See* I A. KAHN, *supra* note 8, at 75, 143-44.

cross-subsidies and predatory pricing by requiring higher rates than pure marginal cost. This factor explains why it is that those with an institutional concern for the prevention of predatory pricing, such as the Antitrust Division of the Justice Department, can support LRIC pricing in the present case.

In short, the FCC's *assumption* that FDC pricing rather than LRIC is *necessary* to prevent cross-subsidies is clearly contrary to a common sense evaluation of the facts and to commonly accepted economic theory. As a result the Commission has *not* shown its standard for minimum rates to be *rationally related* to the prevention of cross-subsidization. By choosing a standard that requires high rates without a showing of reasonable connection to a legitimate regulatory purpose, *the Commission has unjustifiably restrained competition and imposed an unjustifiable price burden on AT&T's competitive service customers.* (Hence the position and role of the Antitrust Division in this case.) The Commission's invalid assumption and conclusions regarding FDC and LRIC pricing *reflect a thoroughly uncertain grasp of the fundamentals of pricing in the industry it regulates.* By accepting the Commission's decision at face value, the majority does nothing to shake it from these fallacies.

The Commission raised several more objections against LRIC pricing in addition to its assumption that LRIC pricing would allow cross-subsidies. While it might be permissible for the Commission to choose FDC pricing after deciding that these other factors outweigh the positive value of LRIC, *a rational balancing is not possible unless one first acknowledges the positive value of LRIC —i.e., that it prevents cross-subsidies without impairing competition as severely as does FDC.*

For purposes of clarification, it is appropriate to comment on the merit of these additional arguments against

LRIC. First is the argument that raising prices in the competitive market will not lose competitive service customers for AT&T. The FCC considers it "arbitrary" of AT&T to single out competitive service customers for marginal cost pricing; why, the Commission asks, doesn't the firm use marginal cost pricing for monopoly customers as well? [27]

The simple answer is that it is only the competitive service customers who are likely to be lost through slight increases in prices. The ground for difference in treatment is that elasticity of demand is greater in competitive markets than in monopoly markets.[28] It is only in the competitive market that AT&T must respond to competition by keeping rates at a low competitive level. Thus it is simply the facts of economic life, and not an invidious bias against monopoly service customers, that induces AT&T to lower its competitive service prices toward the LRIC level. As we have seen pricing anywhere above LRIC cannot result in a subsidy. The Commission, on the other hand, appears to reject elasticity-based pricing generally, when it states (quoting the Recommended Decision) that

> [w]hen economists suggest (as in this proceeding) the use of 'inverse elasticity rules' for price discrimination among services or classes of customers to allow the company to meet its overall revenue requirement, they are suggesting that those customers with inelastic demand subsidize those with elastic demand.[29]

To follow the reasoning of this statement to its logical conclusion *would prohibit elasticity-based pricing wherever*

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[27] *See In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 614, 626-27, 629, 639.

[28] *See* I A. KAHN, *supra* note 8, at 140-44.

[29] *See In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 642.

found for all regulated firms—such *a direct contradiction of the normal workings of competitive pricing* is not justified by the record or reasoning of the Commission in this case.

This line of reasoning leads to a further grave flaw in the Commission's opinion. By requiring an increase in competitive service rates to the FDC level in order to prevent cross-subsidies, the Commission implicitly assumes that this increase in rates will produce a rise in revenues. *But this will happen only if demand is inelastic.* Not only has the Commission shown no reason to believe that demand is inelastic, but it admits that this is a competitive market, which by nature should tend toward elastic demand. *Thus the Commission has offered no evidence to show a probability or even a reasonable hope* that raising AT&T's competitive service rates to the FDC level will not price AT&T out of the market, and thus eliminate any and all contribution that the competitive service customers were making to common and joint costs.

The Commission perhaps recognizes this flaw in its reasoning, for it argues that even if AT&T loses competitive service customers with price increases in the competitive market, its expanding monopoly services will soon utilize the idle facilities.[40] But the existence of idle facilities is not the important factor here; the important fact is that without competitive service customers, the firm loses the contribution to common or joint costs that is provided whenever competitive service customers pay a rate even slightly higher than LRIC. Thus the loss of competitive service customers will hurt monopoly service customers, whether or not the competitive service facilities remain idle only temporarily.

Finally, the FCC maintains that whatever the merits of LRIC pricing, the Commission's other objections justi-

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[40] *See id.* at 640.

fied the use of FDC pricing.[41] The Commission emphasizes the objective of accountability, which requires that any costing methodology be verifiable so that the FCC can ensure that AT&T will not allow cross-subsidies to arise in its pricing structure.[42] The Commission alleges that LRIC is subjective, in the sense that it "is heavily dependent upon judgmental decisions which cannot be verified or tested by the Commission."[43] While such considerations may certainly enter into a rational weighing of the merits of LRIC versus FDC, the Commission should not overlook the subjectivity and arbitrariness that are unavoidable in the FDC method, which performs the inherently arbitrary task of assigning unattributable costs to particular services. And if current reporting procedures do not generate data for the verification of LRIC pricing, the FCC should consider the possibility of developing procedures that can generate such data.

The FCC also maintains that its allowance for price reductions below FDC upon a showing of competitive necessity supports the rationality of its decision.[44] There are two criteria for allowing a competitive necessity exception to the general requirement of FDC pricing: (1) an alternative supply source that customers will utilize unless they are given the benefits of price discrimination, and (2) a benefit from discrimination for users who are discriminated against.[45] The problem is that the Commission's requirement of a showing of a "*real* competitive threat"[46] is very difficult to satisfy, and was not satisfied

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[41] *See id.* at 636 n.80.

[42] *See* Brief for FCC at 30, 50, 54; *In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 610-12.

[43] *In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 632.

[44] *See* Brief for FCC at 53.

[45] *See In re American Tel. & Tel. Co.*, 61 F.C.C.2d at 590.

[46] *Id.* (emphasis in original).

in this case, even though the market in question was admittedly competitive. The FCC's standards ignore that if there is a legitimate concern on the part of the firm for pricing at low levels, it must be because there are actual or potential competitors. The FCC conceded that the private line services market is a competitive market when it initiated Docket No. 16,258.[47] But it apparently will allow competitive pricing in competitive markets only upon a showing of exceptional circumstances. The "zone of reasonableness," that the Commission claims to allow for prices,[48] thus turns out to exist only in exceptional cases.

CONCLUSION

As stated above, it is possible that a rational balancing of all factors might favor FDC pricing, despite the economic pro-competition advantages of LRIC and its ability to prevent cross-subsidies. The economic muddle of the FCC's analysis in this case, however, makes it clear that the Commission never recognized the economic merits of LRIC, and that it assumed FDC pricing to be necessary to prevent cross-subsidies. It thus was *unable to give rational consideration to the balancing of the needs to promote competition and to prevent cross-subsidies*, which under all standards of judicial review makes it impossible for this court to affirm agency action demonstrably resting on no rational base.

The primary effect of forcing AT&T's competitive service prices up to the FDC level *is to protect its competitors in that market.* In the words of the Department of Justice, "the Commission confuses protecting competitors and protecting competition."[49] This result contrasts sharply with the Commission's earlier announced policy

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[47] *See id.* at 592.

[48] *Id.* at 641.

[49] Reply Brief for Respondent United States of America at 9 n.10.

of refusal to provide a "protective umbrella" for new entrants into AT&T's markets.[50] *And it imposes a high cost on AT&T's consumers, a cost not justified on the record before us.*

The complexity of analysis in this case might lead one to question the certainty with which a court can say that the Commission acted arbitrarily.[50a] But in this case the arbitrariness of the FCC's reasoning is very simply and clearly demonstrated by the absurdity of its result: under the FCC's prescribed costing procedures, the maximum level of rates set to prevent monopoly pricing is exactly identical to the minimum level established to prevent predatory pricing and cross-subsidies. The Justice Department accurately summarizes the effect of this ruling as follows: "AT&T, subject to extremely narrow waiver provisions, will as a practical matter have virtually no freedom to price a service any differently than it prices its basic monopoly services, *notwithstanding possible efficiencies.*" [51] If AT&T raises rates above the prescribed level, it is guilty of monopoly pricing; if it lowers them below this level, it is guilty of cross-subsidizing and, in effect, predatory pricing—or so decrees the Commission.

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[50] *See Specialized Common Carrier Services*, 29 F.C.C.2d 870, 915 (1971).

[50a] For example, in *American Commercial Lines, Inc.* v. *Louisville & N.R.R.*, 392 U.S. 571 (1968), the Supreme Court stated in dictum that it was reluctant to pass on the merits of marginal cost economic arguments. *Id.* at 586 n.16. But the Court added at the end of this footnote: "Our discussion here should not be interpreted as a rejection of the basic economic points made by the railroads. It is merely intended to illustrate the desirability of having the *initial resolution* of these issues made by a tribunal, and in a proceeding, more suitable than the present one." *Id.* at 589 n.16 (emphasis added).

[51] Brief for Respondent United States of America at 35 (emphasis in original) (citations deleted). *See also In re American Tel. & Tel. Co.*, 64 F.C.C.2d at 978 & nn.13-14 (1977) (on petitions for reconsideration).

Even apart from economic analysis, common sense alone suffices to show that there must be *some range* of prices, within which firms have discretion to choose in a competitive market without being immediately accused of either monopoly pricing or predatory pricing. Otherwise business judgment and price competition have no role whatever in the market. Much as courts should normally defer to an agency's expertise, there is some limit beyond which a court must step in. When an agency arrives at a decision so contrary to common sense and economic logic as this, we have reached that limit.[52]

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[52] A simple example, in a situation familiar to judges, lawyers, law teachers, and even law students, will make clear the above economic exposition, even if the reader has no background in economics whatsoever. This example will illustrate the fundamental difference between these two cost and pricing concepts, and show the basic fairness and ultimate economic utility of long-range incremental cost pricing.

Suppose that Judge X is called by the moot court board at Anywhere Law School and invited to come to Anywhere and sit as a judge in the moot court finals. The board representative states that all of Judge X's actual out-of-pocket expenses will be paid. Judge X, interested in giving a pleasant outing to his wife, inquires if the invitation, all expenses paid, includes Mrs. X in the hospitality. The person in charge replies, "I am sure that Mrs. X would be very welcome, and we'll be glad to make any arrangements for her at the hotel, but at the moment I can't say whether the moot court board is in a position to pick up her expenses at the hotel." Judge X replies, "I would like to bring Mrs. X anyway, so please make the reservations for her and we'll see later where the expense is to be charged."

Judge and Mrs. X attend the moot court, the bill at the hotel for the two is $150 a day, full American plan, and Judge X carefully notes that it would have been $125 a day for him alone. On return he sends in his itemized statement of expenses and notes that the question of whether the moot court board is picking up the expenses of Mrs. X had not been resolved—if they are, he should be reimbursed at $150 a day; if not, he should be reimbursed at $125 a day.

The moot court board replies, saying that they are very sorry but they cannot pick up the hotel expenses of Mrs. X and that they are enclosing a reimbursement for Judge X's expenses calculated on a basis of $75 a day. Judge X doesn't understand this. If he had gone alone, it is very clear that he would have been reimbursed at $125 a day for himself alone, because this is what the charge for the room, full American plan, plainly was. The added increment for Mrs. X was only $25 a day at the most. It is clear that the moot court board would have had to pay $125 a day for Judge X alone, and this was their original invitation on this basis.

The moot court board replies, "Judge X, you don't understand fully distributed costs. It's obvious that the facilities at the hotel, including room and meals and all services, were enjoyed equally by you and Mrs. X. One half of $150 a day is $75 a day, which is the cost properly allocated to you alone. It is true that if you had come by yourself, the cost would have been $125 a day, and we would have reimbursed you on that basis, but you didn't come alone, you added another pleasurable increment to your visit here, namely, the company of Mrs. X, and that part is properly chargeable to Mrs. X and you, and not to the moot court board. We believe in the economics of fully distributed costs, and fully distributed costs means $75 allocated to Mrs. X and $75 allocated to Judge X. We are paying only for Judge X.

Judge X further protests, "If I had known you were going to charge on this basis, I would never have brought Mrs. X at $75 a day. I would have come by myself at the agreed all-expense rate, payable at $125 a day for me, and never brought Mrs. X into the picture. If there is anything I'm clear about, it's the unfairness of this retroactive application of your theory on costs. You did say it was undecided whether you could pay for Mrs. X or not, but you never said that you were going to charge for my expenses on a different basis if I brought Mrs. X. This retroactive application is the most unfair thing of all."

The moot court board replies, "If there is anything clear from our point of view, it is that you were on full notice that we might or not pay Mrs. X's expenses, and if we couldn't pay Mrs. X's expenses, surely you must realize that we were at liberty to use the logical method of fully distributed costs in

calculating the expense properly chargeable to you and to her. The fact that we made up our minds later as to whose expenses to pay and by which method to calculate the costs is immaterial. You were on full notice of this all along."

The parallel with the AT&T situation is obvious. The cost for monopoly services is fixed, and will be the same whether the competitive services are added by AT&T or not. The cost for the monopoly services is the equivalent of the $125 which would have been the hotel charge for Judge X alone; the cost for the competitive services would be the additional $25 which would be added if Mrs. X enjoyed the use of the same services. From the hotel's point of view, the additional cost for Mrs. X's presence is only the additional linens and the food, and therefore the incremental cost for her presence is a relatively small amount compared to the basic cost of providing that one room and facilities for one person. (The hotel might calculate that the presence of Mrs. X would generate sales in the shops on the hotel premises and thus add a small amount to hotel revenues, and thus the hotel could encourage her presence by charging even less than the cost of the linens and food and still make a profit on the incremental services. Similar comparisons might be made to AT&T services.)

To apply fully distributed costs to the stay of the couple at the hotel is economic nonsense; it is unquestionably true that considered *ab initio* the cost of providing the room and food for the two persons can be divided equally, $75 apiece, but this bears no relation to the economic logic of the way to conduct a hotel business or to conduct a moot court board's business either. What the moot court board was faced with from the start was paying the total expenses of Judge X, which amounted to $125 at the price charged by the hotel. Similarly, the price charged by the hotel for Judge X individually was what it cost to put one person in the room and provide meals and all services, with a reasonable profit.

Both the hotel and the moot court board should logically and sensibly run their business on an incremental cost basis, just as is advocated by AT&T and the Antitrust Division in our case. The basic cost of having Judge X come to the moot court is going to be $125 a day whether Mrs. X comes or not. The board is logically forced to pay this price. The advent of Mrs. X is something entirely within the control of Judge X; she can come or not, and if she does come, there is no

I would therefore vacate the relevant parts of the Commission's decision and remand; hence I respectfully dissent from Part II A and concur separately in Part II C of the majority opinion.

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moral or economic right of the moot court board to profit by the incremental service the hotel is providing for Mrs. X by reducing the cost allocated to Judge X's presence, which logically still remains at $125 a day and is not either economically or equitably reducible to $75.

Similarly, the charges which the monopoly customers of AT&T have been paying and which have been previously determined as fair, based on the costs of AT&T in providing these services, should not necessarily be reduced simply because AT&T can inaugurate other services in the competitive market. The costs properly allocated to the new competitive services of AT&T are incremental costs, not fully distributed costs, because the costs of the monopoly services should remain the same irrespective of whether AT&T enters competitive markets or not. (Actually, as shown by the detailed economic exposition above, there is hope that the competitive services of AT&T, with incremental cost pricing, will definitely contribute to a lowering of costs for the monopoly service customers.)

Of course, as Judge X would probably indignantly point out in our hypothetical case, the retroactive determination by the moot court board to reimburse him on the basis of fully distributed costs, *i.e.*, only $75 for his half of the hotel room and services, is the most unfair and illogical action of all. While Judge X did understand that the moot court board might or might not pay for Mrs. X, he doubtless thought that surely the question of the cost of *his* own visit was fully settled, and would not be affected by whether the incremental cost of Mrs. X was added. This compares with AT&T knowing that the whole question of an ultimate costing was yet to be decided, but surely AT&T should not be penalized retroactively on a fully distributed cost theory, when the cost of its monopoly services would have remained the same over the years, whether AT&T had added the incremental services or not.

Appendix B

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-1333

AERONAUTICAL RADIO, INC., ET AL., PETITIONER,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN BROADCASTING COS., INC., ET AL., AMERICAN TELEPHONE AND TELEGRAPH CO. AND MICROWAVE COMMUNICATIONS, INC., WESTERN UNION TELEGRAPH COMPANY, INTERVENORS.

No. 77-1521

AERONAUTICAL RADIO, INC., AND AIR TRANSPORT ASSOCIATION OF AMERICA, PETITIONERS,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, CONSOLIDATED RAIL CORPORATION, MICROWAVE COMMUNICATIONS, INC. MCI TELECOMMUNICATIONS CORP., AND AMERICAN NEWSPAPER PUBLISHERS, ET AL. INTERVENORS.

No. 77-1544

GENERAL ELECTRIC COMPANY, PETITIONER,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN TELPHONE AND TELEGRAPH COMPANY, AND MICROWAVE COMMUNICATIONS, INC., ET AL., INTERVENORS

No. 78-1368

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, PETITIONER,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN BROADCASTING COMPANY, INC. & CBS, INC.,
&
NATIONAL BROADCASTING COMPANY, INC. AND DOW JONES & CO., INC., INTERVENORS

Before: BAZELON, *Senior Circuit Judge*, ROBB and WILKEY, *Circuit Judges*.

Filed: November 5, 1980

ORDER

Upon consideration of the petition for rehearing filed by intervenor American Telephone and Telegraph Company, and of the additional memorandum of the intervenor filed on August 6, 1980, it is

ORDERED, by the court, *sua sponte*, that the Opinion for the Court, filed on June 24, 1980, be, and it hereby is, amended as follows:

(a) On page 4 of the slip opinion, strike the last two lines of the first paragraph of text and substitute in lieu thereof the following:

> (4) dismiss the petitions to review the Commission's acceptance of a tariff filing.

(b) On page 13 of the slip opinion, add after the last sentence of the carryover paragraph the following footnote 12:

> [12] This court's jurisdiction to review the FCC's Order prescribing fully distributed costs as the relevant standard for ratemaking (FDC Order) is invoked pursuant to section 402(a) of the Communications Act, 47 U.S.C. § 402(a) (1976), and 28 U.S.C. § 2342 (1976). The FDC Order is final for purposes of judicial review for several reasons. The denial by the FCC of the petitions for reconsideration of its FDC Order (64 F.C.C.2d 971) constitutes exhaustion of the administrative remedies available under 47 U.S.C. § 405 (1976). Although the FDC Order was issued pursuant to the FCC's statutory mandate under 47 U.S.C. §§ 201(b), 205 (1976) to prescribe "just and reasonable" rates (64 F.C.C.2d at 972), this is not the type of order which must be challenged pursuant to the mandatory complaint procedures of 47 U.S.C. §§ 206–209 (1976) prior to judicial review. As discussed *infra* at page 24, *et seq.*, the mandatory complaint procedure is appropriate when damages for allegedly illegal rate levels are being sought. The cost standard inquiry at issue here, on the other hand, "is not primarily a typical 'rate case' designed to test the lawfulness of specific charges . . . ." (64 F.C.C.2d at 972) In prescribing fully distributed costs and rejecting long run incremental costs as the relevant standard for ratemaking, the FCC was engaged in rulemaking. As the FCC admitted, "the purpose and effect of this proceeding is to establish basic principles

and standards of general applicability for determining cost of service and corresponding rate levels, by service category." (64 F.C.C.2d at 972) The question now is whether the FCC Order was the product of arbitrary and capricious action, not whether a rate is just and reasonable.

Moreover, because this court holds in this case that Telpak users must first pursue statutory complaint procedures to test the legality of the new rates (*see* page 24, *et seq.*, *infra*), common sense suggests that this is the appropriate time for judicial review of the validity of the relevant standard for assessing the legality of the rates. Postponement of judicial review of the FDC Order until after the final order regarding the legality of the new rates would be to place the cart before the horse.

(c) On page 15 and on the following pages of the slip opinion, footnotes 12 through 27, inclusive, are renumbered footnotes 13 through 28, respectively.

(d) On page 23 of the slip opinion, add after the last sentence of the second paragraph the following:

The Commission held that "Section 214 does not apply to the instant tariff revisions" because the termination of Telpak constituted a tariff change rather than the discontinuance of a service. 64 F.C.C.2d at 965.

On a question of statutory interpretation like that involving Section 214, this court must show "great deference to the interpretation given the statute by the officers or agency charged with its administration." *Udall v. Tallman*, 380 U.S. 1, 16 (1965). The agency's interpretation "should be followed unless there are compelling indications that it is wrong." *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969). There are no such indications here.

(e) On page 23 of the slip opinion, strike the first sentence of the last carryover paragraph and add in lieu thereof the following:

We agree with the FCC's holding that § 214(a) did not apply in this case.

(f) On page 24 of the slip opinion, strike the heading "2. 47 C.F.R. § 61.38" and the text thereunder. Strike pages 25, 26, 27 and 28 in their entirety. Substitute in lieu thereof the following:

2. Reviewability and 47 C.F.R. § 61.38

Section 61.38 of the Commission's rules, 47 C.F.R. § 61.38, requires certain supporting economic data to be filed with proposed tariff changes.[29] In this case the Commission held that § 61.38 was not applicable to the Telpak filing. 64 F.C.C.2d at 966. In addition, the Commission held that, even if § 61.38 were applicable, it would exercise its discretion and waive the rule. *Id.* Petitioners assert that because § 61.38 was applicable and its waiver by the Commission was an abuse of discretion, we must order the agency to reject the tariff filing. (Jt. Br. of Aeronautical Radio and Air Transport Ass'n of America at 26) We hold that this court cannot review the Commission's decision to accept the tariff filing at this time. Failure to comply with the tariff filing rule of § 61.38 creates no power in this court to compel rejection.

a. The Commission's acceptance of the tariff filing is not reviewable at this time.

This court has repeatedly held that agency decisions relating to the acceptance of a tariff filing are non-final orders, generally not subject to judicial re-

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[29] Such data must include a cost of service study for all elements of cost for the most recent 12-month period and a projection of costs for a three-year period beginning at the date of the filing of the tariff matter. 47 C.F.R. § 61.38(a)(2)(i). Also, the carrier must submit estimates of the effects of the tariff change on the carrier's traffic and revenues for the prior year and the succeeding three years. *Id.*, § 61.38(a)(2)(ii). Finally, for tariff changes embodying rate increases of the magnitude proposed by AT&T, all cost, marketing, and other data relied on to justify the change must be filed. *Id.*, § 61.38(d).

view.[30] Most recently in *Papago Tribal Utility Authority v. FERC*, No. 79-1562 (D.C. Cir. June 23, 1980), *petition for cert. filed*, 49 U.S.L.W. 3252 (Sept. 22, 1980) (No. 80-465) this court declined to review the acceptance by the FERC of a rate filing under the Federal Power Act where patent defects in form or content were alleged.[31] (Slip op. at 26) The court asserted that acceptance orders are generally unreviewable when they are (1) non-final, (2) result in no irreparable harm to the party seeking review, and (3) constitute a province reserved to agency discretion. (Slip op. at 7)

The decision of the FCC to accept the AT&T tariff filing satisfies the *Papago* criteria of unreviewability. The acceptance is non-final because it is the initiation of an administrative proceeding. The Commission merely accepted the tariff and did not rule on the lawfulness of the rates to be paid by former Telpak customers. The act of acceptance creates no irreparable harm because investigatory hearings are available for examination of the filing on the merits. 47 U.S.C. §§ 206-209; *Papago*, slip op. at 10-11. Finally, the decision to accept the filing is reserved to Commission discretion because it is a "necessary adjunct to the unreviewable decision to suspend and investigate." *Papago*, slip op. at 16. *See Southern Railway Co. v. Seaboard Allied Milling Corp.*, 442 U.S. 444, 454 (1979); *Arrow Transportation Co. v. Southern Railway Co.*, 372 U.S. 658, 667-669 (1963). As the court in *Papago* observed, "It would make little sense to declare orders concerning suspension and investiga-

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[30] *See, e.g.*, Asphalt Roofing Mfg. Assoc. v. ICC, 186 U.S. App. D.C. 1, 8, 567 F.2d 994, 1001 (1977); Texas Gas Corp. v. FPC, 102 U.S. App. D.C. 59, 61, 250 F.2d 27, 29 (1957).

[31] Section 205(d) of the Federal Power Act, 16 U.S.C. § 824d(d) (1976) is comparable to the notice provisions of the Communications Act, 47 C.F.R. § 61.58 (1977).

tion unreviewable if the courts may review the related order to accept a rate filing." (Slip op. at 16)[32]

The *Papago* decision relied upon a series of Supreme Court cases,[33] including the *Southern Railway* decision, in which it was held that appellate courts have no power to interfere with agency discretion by undertaking to review suspension, investigation, and rejection decisions. 442 U.S. at 452. In the *Southern Railway* case the Interstate Commerce Commission accepted a railroad tariff increase without suspension, investigation, or hearing, despite assertions by protestant shippers that the rates were patently illegal. 442 U.S. at 449. The Court held the ICC actions to be non-final and unreviewable because the complaint procedure of the Interstate Commerce Act, "which allows shippers to initiate mandatory post-effective proceedings to inquire into and remedy violations of the Act, would still be available to 'protect' persons aggrieved by the rates." 442 U.S. at 450 (footnote omitted). In the present case, as in *Southern Railway*, there has been an acceptance of a tariff increase without suspension, investigation, or a hearing, and a complaint procedure under the Communications Act comparable to that of the Interstate Commerce Act is available for former Telpak customers.[34] The *Papago*

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[32]The court in *Papago* also observed that "[w]e are not concerned in this case with orders that accept tariff filings and allow them to take effect without investigation or refund obligation. Such orders would present different questions of reviewability." (Slip op. at 5 n.8) For the reasons discussed above and in the Opinion on Petition for Rehearing, we nevertheless consider the *Papago* decision to be applicable to the facts of this case.

[33]*See, e.g.*, Arrow Transportation Co. v. Southern Railway Co., 372 U.S. 658 (1963); American Farm Lines v. Black Ball Freight Service, 397 U.S. 532 (1970).

[34]47 U.S.C. §§ 206–209 (1976). Under these provisions protestants may seek actual damages if they believe rates are unlawfully high. Here, as in *Southern Railway*, the complaint procedure shifts the burden of proof onto the aggrieved party and

and *Southern Railway* cases require us to hold that the availability of a statutory complaint procedure renders the FCC's acceptance decision in this case non-final.

b. The Commission's waiver of Rule 61.38 is not reviewable.

Cost justification information is submitted pursuant to the FCC's tariff filing rules primarily to aid the Commission in exercising its discretion as to investigation and suspension of tariff filings. *Tariffs-Evidence*, 40 F.C.C.2d 149, 152–153 (1973). It follows that the FCC's determination as to what data it requires in making this discretionary decision cannot provide a basis for this court to mandate rejection of the tariff filing. Although another purpose of the tariff filing rules is to provide customers, competitors, and the public with information that will serve as a basis for comment,[35] the rules were not "intended primarily to confer important procedural benefits upon individuals." *American Farm Lines v. Black Ball Freight Service*, 397 U.S. 532, 538 (1970); *Associated Press v. FCC*, 145 U.S. App. D.C. 172, 181, 448 F.2d 1095, 1104 (1971). An agency is per-

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may restrict his ultimate relief to actual damages rather than to the full overcharge that would have been available had the FCC ordered an investigation. *Id.* As the Court noted in *Southern Railway*, however, neither of these two determinations "necessarily affects any citizen's ultimate rights" so as to permit judicial review. 442 U.S. at 454–455 & n.8 (footnote omitted).

The complaint procedures of the Communications Act are a realistic remedy for Telpak customers. Because we find Telpak to be a discount bulk *rate* offering (slip op. at 23–24) customers can allege that the remaining private line rates are unlawfully high. We need not concern ourselves with the Commission's possible lack of power to mandate reinstitution of a *service*.

[35] *See Amendment of Part 61*, 25 F.C.C.2d 957, 970–71 (1970); *Part 0—Commission Organization*, 57 F.C.C.2d 1122, 1123 (1976); *Amendment of Parts 0, 1 and 61*, 62 F.C.C.2d 474, 476 (1976).

mitted to relax, modify, or waive its filing requirements, *City of Groton v. FERC*, 190 U.S. App. D.C. 86, 89 n.8, 584 F.2d 1067, 1070 n.8 (1978), and such action is not reviewable except upon a showing of substantial prejudice to the complaining party. *Papago*, slip op. at 22. Given the complaint remedy under the Communications Act, no substantial prejudice of an irreparable nature exists in this case.[36]

This court nevertheless regrets the Commission's summary procedures as applied here. Such actions deprive the public of potentially valuable information and force protestants to institute a cumbersome complaint procedure to address the merits of the tariff revision. For the reasons noted above, however, we cannot review the Commission's orders until the statutory complaint procedures have been followed. Because we find that there has been no reviewable final order in the Commission's proceedings, we direct that the petition for review be dismissed.

Judgment in accordance with this opinion

And it is

FURTHER ORDERED, by the court, that intervenor's petition for rehearing is granted, for the reasons set forth in the panel opinion on rehearing filed this date.

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[36] *See* note 6 *supra*. Furthermore, the Court in *Papago* asserted that *Southern Railway* and *Arrow Transportation* show that "a nonfinal administrative order may be unreviewable—*even though it might result in serious irreparable injury to a party*—if immediate judicial review would undermine the authority of the agency acting within the scope of its discretion." (Slip op. at 16) (Emphasis added)

Appendix C

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-1333

AERONAUTICAL RADIO, INC., ET AL., PETITIONER,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN BROADCASTING COS., INC., ET AL., AMERICAN TELEPHONE AND TELEGRAPH CO., MICROWAVE COMMUNICATIONS, INC., AND WESTERN UNION TELEGRAPH COMPANY, INTERVENORS.

No. 77-1521

AERONAUTICAL RADIO, INC., AND AIR TRANSPORT ASSOCIATION OF AMERICA, PETITIONERS,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, CONSOLIDATED RAIL CORPORATION, MICROWAVE COMMUNICATIONS, INC., MCI TELECOMMUNICATIONS CORP., AND AMERICAN NEWSPAPER PUBLISHERS, ET AL. INTERVENORS

No. 77-1544

GENERAL ELECTRIC COMPANY, PETITIONER,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, MICROWAVE COMMUNICATIONS, INC., ET AL., AND INTERVENORS

No. 78-1368

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, PETITIONER,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS,

AMERICAN BROADCASTING COMPANY, INC. & CBS, INC., & NATIONAL BROADCASTING COMPANY, INC., DOW JONES & CO., INC., INTERVENORS.

On Petition for Rehearing

Filed: November 5, 1980

Before: BAZELON, *Senior Circuit Judge*, ROBB and WILKEY, *Circuit Judges*.

Opinion for the Court filed by *Circuit Judge* ROBB

ROBB, *Circuit Judge*: The American Telephone & Telegraph Company (AT&T) seeks a rehearing, asserting, among other things, that this panel erred in (1) reviewing

the decision of the FCC to accept the Telpak rate filing and (2) ordering the FCC to reject the filing on the ground that the agency abused its discretion in waiving Rule 61.38 (47 C.F.R. § 61.38). (Petition of AT&T at 2) AT&T argues that this panel's decision conflicts with the decision of another panel of this court, *Papago Tribal Utility Authority v. FERC*, No. 79-1562 (D.C. Cir. June 23, 1980), *petition for cert. filed*, 49 U.S.L.W. 3252 (Sept. 22, 1980) (No. 80-465), as well as with a Supreme Court decision relied upon by the *Papago* court, *Southern Railway Co. v. Seaboard Allied Milling Corp.*, 442 U.S. 444 (1979). (Petition of AT&T at 2-3) Because we are in substantial agreement with these contentions we grant the petition for rehearing and amend the panel decision by the attached order.

Our initial decision to review the Commission actions and to compel rejection of the filing was based on our conclusion that the agency had been unjustifiably summary in its procedures, given the $100 million per year impact of this tariff revision. The events preceding the acceptance of the Telpak filing suggest that but for the Commission's rescinded order of discontinuance, the agency would likely have required the § 61.38 cost justification date. As noted in the original panel opinion, *Aeronautical Radio, Inc., et al. v. FCC*, No. 77-1333 (D.C. Cir. June 24, 1980) (slip op. at 11-12), the FCC initially ordered AT&T to discontinue Telpak. Such agency-initiated rate changes are not subject to the § 61.38 requirements. Subsequently, after the FCC ordered resale and sharing of the Telpak service and withdrew its termination order, the tariff revision at issue (a carrier-initiated discontinuance) was filed by AT&T. *Id.* The Commission, we felt, employed the summary acceptance procedures which were appropriate for an agency-initiated discontinuance but which were inappropriate in the new circumstances. For this reason we ordered rejection of the tariff filing and left open the possibility of a refiling with cost justification data by AT&T. (Slip op. at 27-28)

On rehearing, although our discontent with the Commission's actions remains, we think upon further reflection that the *Papago* and *Southern Railway* cases preclude us from reviewing the FCC order. Both these decisions, in which courts declined to review agency orders regarding acceptance of rate revisions, might be distinguished as involving agency procedures less summary than those employed by the FCC here. The *Papago* customers had the protection of (1) cost justification date, (2) suspension of the increased rates, (3) an ordered hearing on the merits of the rate increase, and (4) a refund order of the full overcharge if rate increases were found unlawful. *Papago*, slip op. at 10–11. In *Southern Railway*, although there was no suspension or ordered hearing, the customers had the protection of (1) cost justification data, (2) ICC orders requiring the Railroad to document the effects of the rate changes, and (3) agency monitoring of the Railroad's financial condition. 442 U.S. at 449–50. The AT&T customers had none of these protections. Their only resort is to the complaint procedure of the Communications Act. (47 U.S.C. §§ 206–209) Under both *Papago* and *Southern Railway*, however, this remedy alone suffices to render the FCC order non-final and unreviewable. The factual differences between those cases and this case are differences without a distinction.

Judgment in accordance with this opinion.

Appendix D

Common Carrier, Rates, Charges, see also Tariff
Common Carrier, Service, Discontinuance Of
Common Carrier, Service, Resale And Shared Use Of
Private Line Service
Telpak

Petitions to Reject and Petitions to Suspend and Investigate tariff revisions cancelling bulk rate private line offering of Tariff F.C.C. No. 260 (Private Line Service), Series 5000 (Telpak) denied.

F.C.C. 77-384

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
AMERICAN TELEPHONE AND TELEGRAPH COMPANY, LONG LINES DEPARTMENT Revisions to Tariff F.C.C. Nos. 258 and 260 (Series 5000)—Termination of Telpak Service	Transmittal No. 12714

MEMORANDUM OPINION AND ORDER

(Adopted: June 2, 1977; Released: June 13, 1977)

BY THE COMMISSION: COMMISSIONER HOOKS DISSENTING; COMMISSIONER WASHBURN DISSENTING AND ISSUING A STATEMENT; COMMISSIONER FOGARTY DISSENTING AND ISSUING A SEPARATE STATEMENT; COMMISSIONER WHITE CONCURRING IN THE RESULT.

1. We here consider Petitions for Suspension and Investigation and Petitions for Rejection of the above-captioned tariff filing.[1] Transmittal No. 12714 of the American Telephone and Telegraph Company, Long Lines Department (AT&T), was filed March 23, 1977, and gave 77 days' notice of the accompanying revisions to AT&T's Tariff F.C.C. No. 260 (Private Line Services). The revisions are scheduled to become effective June 8, 1977, and provide for the cancellation of Series 5000 service (Telpak). Telpak service is a "bulk rate" offering which offers

[1] Petitions for Suspension and Investigation of these tariff revisions were filed on behalf of The General Electric Company (GE); the Executive Agencies of the United States Government (Executive Agencies); the American Newspaper Publishers Association, The Associated Press, Commodity News Service, Inc., United Press International, Inc., Dow Jones & Company, Inc., and Reuters Limited (collectively Press Parties); Aeronautical Radio, Inc. (ARINC); the Aerospace Industries Association of America, Inc. (AIA); the Air Transport Association of America (ATA); the National Retail Merchants Association (NRMA); and the Consolidated Rail Corporation (Conrail). Conrail filed an "Emergency Request to File a Petition to Suspend, Investigate, and Order an Accounting." For good cause shown, Conrail's Petition for Suspension is accepted as a late-filed pleading. AT&T filed a Reply to these Petitions, except that of Conrail. Petitions for Rejection were filed by the Press Parties, ARINC, ATA, Conrail and the National Association of Motor Bus Owners (NAMBO). AT&T has filed an Opposition against the petitions. We also received a late-filed Petition for Suspension and Investigation filed by the Automotive Dismantlers and Recyclers of America (ADRA). Although filed too late to be incorporated herein, that Petition raises no arguments not covered by this decision.

private line communications service to large users at a unit cost significantly lower than the rate for "like" services in other tariff provisions, such as the Series 1000 (teletypewriter grade channels), Series 2000 (voice-grade voice channels), and Series 3000 (voice-grade data channels) private line offerings. AT&T stated that no replacement bulk rate was filed because it is AT&T's business judgment that no bulk rate offering is feasible in a resale and sharing environment.

I. *Background*

A. Events Preceding Transmittal No. 12714

1. *Resale and Shared Use*—Docket No. 20097

2. Docket No. 20097[2] (*Resale and Shared Use*) was designated to investigate whether, and under what conditions, users of common carrier communications services should be allowed to resell or share such services. 47 F.C.C. 2d 644 (1974). Our final conclusion in that proceeding regarding all private line services, including Telpak, was that unlimited sharing and resale is just and reasonable.[3] Thus we ordered AT&T to revise its private line tariffs to eliminate the restrictions which prohibited resale or shared use. These tariff revisions were ordered to be filed by March 23, 1977.[4]

2. The *Private Line Rate* case—Docket No. 18128

3. AT&T originally attempted to justify Telpak as a response to competition from privately-owned microwave systems. *Telpak*, 37 F.C.C. 1111 (1964). Four sizes of channels were offered: Telpak "A" was equivalent to 12 voice-grade circuits, "B" to 24 voice-grade circuits, "C" to 60 voice-grade circuits and "D" to 240 voice-grade circuits. Telpak service was found to be a "like" communications service with other private line services which are not obtainable at bulk rates and to cost as much to provide as those other services. The discrimination between Telpak "A" and "B" and the rates for like private line communications services' rates was found to be unjustified by competitive necessity or cost and therefore proscribed by Section 202(a) of the Communications Act, 47 U.S.C. § 202(a). 37 F.C.C. 1111 (1964), *aff'd sub nom. American Trucking Associations, Inc.* v. *FCC*, 377 F.2d 121 (D.C. Cir. 1966), *cert. denied* 386 U.S. 943 (1967). Our investigation found that Telpak "C" and "D" were, at that time, proper competitive responses to privately-owned microwave systems. It was unable to find, however, that Telpak rate levels were compensatory and not an undue burden on AT&T's customers to other services. Consequently we reopened our investigation to allow AT&T a further attempt to show the rates for Telpak "C" and "D" were compensatory, but it was ordered that Telpak "A" and "B" be eliminated. 37 F.C.C. 1111 (1964).

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[2] *Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities (Resale and Shared Use)*, *Report and Order*, 60 F.C.C. 2d 261 (1976), recon. 62 F.C.C. 2d 588 (1977), review pending sub nom., *AT&T* v. *FCC*, Case No. 77-4057 (2d Cir.).

[3] *E.g.*, *Id.* at 289.

[4] Our *Memorandum Opinion and Order* on reconsideration (Docket No. 20097) set the date for the filing of the revisions to be March 18, 1977. 62 F.C.C. 2d 588 (1977). This date was postponed until March 23, 1977, to permit the United States Court of Appeals for the Second Circuit to consider AT&T's motion for stay in oral argument on March 22.

4. Our decision in the *Private Line Rate case* (Docket No. 18128)[5] stated that under current circumstances the TELPAK ["C" and "D"] discrimination is not justified.[6] Therefore we found the discrimination between AT&T's Telpak rates and its rates for other "like" private line services to be unjustified and unlawful. Consequently we ordered:

> That, within eight (8) months from the effective date hereof [AT&T] shall terminate its existing TELPAK offering, but may file a replacement bulk offering consistent with our findings and guidelines herein.

61 F.C.C. 2d at 668-69. On March 23, 1977, AT&T filed Transmittal No. 12714 accompanying proposed tariff revisions which provide for the termination of Telpak service. The revisions are scheduled to become effective on June 8, 1977.

5. Our Order on reconsideration in Docket No. 18128,[7] revokes the above-quoted requirement that Telpak be eliminated. For reasons explained more fully therein, we have concluded that some of the parties to that proceeding might not have been on notice that one of the issues still under consideration was whether the remaining Telpak service is a proper competitive response to privately-owned microwave systems and specialized common carriers under current circumstances. In order to ensure that all the parties to Docket No. 18128 receive, completely and unequivocally, their procedural due process rights in this regard we have designated an expedited hearing on this aspect of Telpak's lawfulness. We have concomitantly rescinded our order that Telpak service be terminated by June 8.

B. Transmittal No. 12714

6. The proposed tariff revisions accompanying Transmittal No. 12714 are described by AT&T as terminating Telpak service without filing a cost-justified bulk rate in replacement because "[i]t is [AT&T's] view that Telpak cannot exist in a resale and sharing environment."[8] Although AT&T's private line tariffs are not required to allow resale and sharing until June 21, 1977, AT&T's termination of Telpak is scheduled to become effective June 8, in accordance with our October 1, 1976 decision in Docket No. 18128. Also filed March 23 to become effective June 8 were proposed tariff revisions reducing longer-distance rates for Series 2000 and Series 3000 private line services. AT&T stated that the rate reductions were filed to mitigate the impact of the elimination of all bulk rate offerings on Telpak customers.[9] No economic information or material accompanied the tariff revisions which will cancel Telpak service. Several users of Telpak service have petitioned us to reject or suspend and investigate the cancelling tariff revisions.

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[5] *American Telephone and Telegraph Co. (Private Line Rate case)*, 61 F.C.C. 2d 587 (1976).
[6] *Id.* at 658-59.
[7] FCC 77-385.
[8] AT&T Transmittal No. 12714, filed March 23, 1977, p. 1.
[9] AT&T Transmittal No. 12716, filed March 23, 1977. We have today added these tariff revisions to our ongoing investigation into the lawfulness of the rates charged for these private line services (Docket No. 20814).

II. *Contentions of The Parties*

A. The Petitioners

7. The primary arguments advanced by the petitioners in favor of rejection are: 1) Transmittal No. 12714 allegedly is a rate increase or a change in rate structure and thus is unlawful for being filed on less than the 90 days' notice required by our rules for those types of tariff changes; 2) no economic information was filed with the tariff revision, as required by Section 61.38 of our rules, 47 C.F.R. § 61.38; 3) the termination of Telpak is said to violate our alleged order in the *Private Line Rate* case to refile Telpak; 4) Telpak cannot be discontinued without prior Commission authorization pursuant to Section 214 of the Communications Act, 47 U.S.C. § 214, and our decision in Docket No. 18128 is insufficient for that purpose; and 5) the cancellation of Telpak is said to violate the stay issued by the United States Court of Appeals in *Commodity News Services, Inc.* v. *FCC*, Case No. 75-2057 (D.C. Cir.). The petitioners urge that even if these arguments are insufficient to support a finding of *prima facie* unlawfulness allowing rejection of the cancelling tariff revisions, the arguments raise questions which require suspension and investigation.

8. In addition to the arguments enumerated above, the petitioners contend that there are other reasons for suspension and investigation of this tariff filing. They maintain that the tariff revision will result in an unlawfully high rate of return for AT&T; that failure to suspend here will constitute prejudgment of the Petitions for Reconsideration filed in Docket No. 18128; that Docket No. 18128 ordered that Telpak be refiled rather than terminated; that AT&T showed no support for its assertion of harm by the resale of Telpak; that a justified bulk rate can and should be devised; and that our Order in Docket No. 18128 recognized that bulk rates are publicly beneficial.

B. AT&T's Response

9. In response to the arguments outlined above AT&T contends that the termination of Telpak was ordered by this Commission and no replacement bulk rate was viable within the constraints of our decision in Docket No. 20097. AT&T states that this tariff filing is not a rate increase and no notice was required by our Order. Moreover, AT&T claims that the petitioners have known that Telpak was to be terminated since October 1, 1976, when our *Private Line Rate* decision was released. That decision ordered the termination of Telpak and gave AT&T the option of filing a replacement bulk rate. The rate of return provided for AT&T's private line services by this tariff filing, in combination with the reductions in MPL rates filed with Transmittal No. 12716, is not unlawful, AT&T says, because Docket No. 18128 set a minimum for AT&T's private line rate of return, but not a maximum. Further, AT&T contends there is no prejudgment here of the Petitions for Reconsideration of Docket No. 18128; no stay has been issued and AT&T is bound to comply with the order to eliminate Telpak.

10. AT&T argues that no authorization pursuant to Section 214 of the Act, 47 U.S.C. § 214, is needed to terminate Telpak because it was done pursuant to Commission Order after a hearing. Since termination was ordered by the Commission, according to AT&T, there is no ques-

tion of lawfulness presented for investigation. AT&T also contends that the stay in *Commodity News Services, Inc.* v. *FCC, supra*, is not a bar to the termination of Telpak because the stay applies only to the enforcement of paragraph 79 of our *Memorandum Opinion and Order in Docket No. 19919* (Hi-Lo), 55 F.C.C. 2d 246 (1975).

III. *Discussion*

A. Rejection of the Proposed Tariff Revisions

11. The grounds upon which we may reject and return tariff filings are (1) failure to publish an effective date, as required by the Communications Act, 47 U.S.C. § 203, and our rules; (2) lack of any requisite Commission-granted authority to provide the service offered by the tariff, such as Section 214 authorization, 47 U.S.C. § 214; and (3) any other *prima facie* unlawfulness such as demonstrably conflicts with the Communications Act or a Commission Rule, regulation or order. *United Video, Inc.*, 49 F.C.C. 2d 878 (1974); *see also, Municipal Light Boards* v. *FPC*, 450 F.2d 1341 (D.C. Cir. 1971), *Associated Press* v. *FCC*, 448 F.2d 1095 (D.C. Cir. 1971). The petitioners herein contend that the proposed tariff revisions at issue come within the latter two of the above-described grounds for rejection. Each of their major contentions will be considered seriatim.

1. The notice period required

12. Section 61.58 of our rules, 47 C.F.R. § 61.58,[10] requires 90 days' public notice for, *inter alia*, tariff revisions which propose a change in rate structure or an increase in rates. The petitioners contend that the instant tariff revisions, in combination with the revisions to the Series 2000 and Series 3000 rates filed with AT&T Transmittal No. 12716, constitute both a rate increase and a change in rate structure. Thus, they argue, that the proposed revisions are *prima facie* unlawful for giving only 77 days' notice.

13. We agree with the petitioners that the termination of Telpak without filing a replacement bulk offering should have been done on ninety days' notice because some Telpak customers, who will receive the same service under Series 2000 or Series 3000, will incur increased charges. There are, however, mitigating circumstances which must be considered in this instance. At the time the tariff revisions were filed AT&T correctly believed it was under a Commission Order, made in Docket No. 18128, to terminate Telpak by June 8. It also was under a concurrent order, made in Docket No. 20097, to file revisions to its private line tariffs permitting resale and shared use of its private line services by March 23 on 90 days' notice. AT&T decided that it would not file a new bulk rate offering to replace Telpak because it believes bulk offerings are not viable in a resale and sharing environment.

14. AT&T states that it chose to file tariff revisions terminating Telpak at the same time it filed its tariff revisions permitting resale and sharing in order to give notice to Telpak subscribers that no replacement bulk rate offering would be filed. The Telpak revisions could not be filed March 23 on 90 days' notice, however, because our Docket

[10] As amended by *Report and Order*, 62 F.C.C. 2d 474 (1976) and *Report and Order*, FCC 77-146, released February 28, 1977.

No. 18128 Order required that Telpak be terminated by June 8. AT&T apparently did not file revisions to cancel Telpak earlier because the United States Court of Appeals did not rule on AT&T's request for a stay of our *Resale and Shared Use* decision until March 22. All AT&T's actions in this regard appear to have been reasonable and taken in good faith.

15. In light of the above-described circumstances we do not believe AT&T's tariff revisions terminating Telpak should be rejected because they were filed on only 77 days' notice. None of the petitioners deny that, at the time the revisions were filed, AT&T was acting pursuant to our Order in Docket No. 18128 to eliminate the current Telpak offering. Thus, the petitioners have known since October 1, 1976, that Telpak was to be terminated and we find no harm to them in the shortening of the notice period by 13 days. The petitioners' real complaint here is that AT&T did not file a replacement bulk rate offering. AT&T's decision not to file another bulk rate offering does not make these tariff revisions *prima facie* unlawful. Under the circumstances described we believe the best course is to waive 47 C.F.R. § 61.58 for this transmittal. At the same time, and upon a proper request from AT&T, we will waive Section 61.59 of our rules, 47 C.F.R. § 61.59,[11] to allow AT&T to withdraw the cancelling revisions. We believe this offer is consistent with the recision of our order to terminate Telpak. If Telpak termination is withdrawn we will also waive 47 C.F.R. § 61.59 for the other carriers who have filed tariff revisions cancelling their competing bulk rate offerings on the basis of our order to terminate Telpak.

2. A replacement bulk rate offering

16. The petitioners also contend that our final decision in Docket No. 18128 ordered AT&T to file a replacement bulk rate offering. This contention is mooted by today's recision of the Docket No. 18128 orders regarding Telpak. AT&T may continue to provide Telpak service pending completion of the expedited hearing instituted by our Order on reconsideration in Docket No. 18128. To allow AT&T to continue providing Telpak we have offered hereinabove to grant a request for a waiver of 47 C.F.R. § 61.59 to allow withdrawal of the terminating revisions.

3. The requirements of Section 214

17. The pertinent part of Section 214 of the Communications Act of 1934 reads as follows:

> No carrier shall discontinue, reduce or impair service to a community, or part of a community, unless and until there shall first have been obtained from the Commission a certificate that neither the present nor future public convenience and necessity will be adversely affected thereby. . . .

47 U.S.C. § 214(a). The petitioners argue that the above-quoted portion of Section 214 prohibits AT&T from discontinuing Telpak service. AT&T contends that the petitioners' argument discounts the power of this Commission over tariffs and proposed tariffs found in Sections 201-205 of the Communications Act, 47 U.S.C. §§ 201-205.

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[11] 47 C.F.R. § 61.59 requires that tariffs which are filed with this Commission must become effective and remain so for thirty days.

18. We find that Section 214 does not apply to the instant tariff revisions. Our finding that Telpak was a "like" service with other private line offerings [12] meant, under the circumstances of this case, that Telpak offers the same service as those other offerings. A change in rates has never been held to be a discontinuance, reduction or impairment of service to a community requiring prior Commission authorization. *Cf., American Telephone and Telegraph Co.* v. *FCC*, 487 F.2d 864 (2d Cir. 1973). All the services offered by the Telpak tariff are still available from AT&T pursuant to other tariffs or other sections of AT&T's Tariff F.C.C. No. 260; only the rates differ.

19. Some of the petitioners attempt to support their claim that AT&T needs Section 214 authority to discontinue Telpak service by quoting a statement made on behalf of this Commission in another context. In opposing a court stay of our *Resale and Shared Use* decision it was stated in our behalf that "[i]f AT&T does not want to allow resale or sharing of Telpak, it can apply to the Commission for permission under Section 214 to discontinue service." [13]

20. The quoted sentence has been taken out of the context of the circumstances under which it was made. AT&T supported its request for a court stay of our *Resale and Shared Use* decision by claiming it would suffer a hardship if Telpak service were allowed to be resold. In showing the court that such a hardship was not unavoidable, Commission counsel stated:

> *Conclusion*
>
> AT&T has not justified interim relief, and the Court should deny its motion for stay. Its alternative request for interim relief from the [*Resale and Shared Use*] order insofar as Telpak is concerned can be rejected summarily. Telpak has been declared unlawful and must be replaced or withdrawn altogether as a service offering. If AT&T does not want to allow resale or sharing of Telpak, it can apply to the Commission for permission under Section 214 to discontinue the service. [14]

This statement was made in the context of the *Resale and Shared Use* proceeding where the Section 214 issue was not presented and reflects a decision on the part of Commission counsel to stand on the side of caution in making representations to the court. Since the Commission had not yet explicitly decided whether further Section 214 authorization was needed before the bulk offering could be terminated, Commission counsel presented its argument to the court under the assumption that was most favorable to AT&T—namely, that AT&T could avoid any burden from permitting the resale of Telpak by obtaining Section 214 authorization to terminate the service. Examination of our *Telpak* decisions, however, makes it clear that Telpak differs from other private line offerings only in its rates, [15] and that the discontinuance of the special Telpak rate offering does not require Section 214 authorization as long as the basic offering remains available under an alternative rate.

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[12] *Telpak*, 38 F.C.C. 370 (1964), recon. 37 F.C.C. 1111 (1964), *aff'd sub nom., American Trucking Ass'n* v. *FCC*, 377 F.2d 121 (D.C. Cir. 1966), cert. denied 386 U.S. 934 (1967).

[13] Opposition of Federal Communications Commission to Motion of AT&T for Stay Pending Judicial Review, *Western Union Telegraph Co.* v. *FCC*, Case Nos. 76-4237, 77-4067 (2d Cir.), p. 20.

[14] *Id.*

[15] See note 12, *supra*.

4. The lack of economic support material

21. The proposed tariff revisions have also been attacked as unlawful for violation of Section 61.38 of our Rules, 47 C.F.R. § 61.38. That rule requires that economic data and information be filed in support of most tariff filings. No such material was filed with the instant tariff revisions.

22. This argument is without merit. The purpose of Section 61.38 is to facilitate an evaluation of the lawfulness of the proposed tariff revisions changing rate levels or creating new rate structures. We stated this at the time we adopted the rule.

> The information contemplated by the proposed rule is in our view essential to the formulation of new or revised rates. . . . In any event, we regard the information with respect to revenue-cost relationships as basic to the formulation of the essential regulatory judgments we must make with respect to the lawfulness under the Communications Act of new or revised rates tendered by common carriers. [16]

The proposed revisions terminate the Telpak bulk rate offering; they do not change Telpak rate levels nor create a new bulk rate offering with a different rate structure. This is not the type of tariff revision to which Section 61.38 was intended to apply.

23. Even if 47 C.F.R. § 61.38 were found to apply to the cancellation of a bulk rate offering, like Telpak, we would not reject the instant tariff filing due to the peculiar circumstances of this case. When AT&T made this tariff filing it was under a Commission imposed obligation to terminate Telpak. We would not reasonably expect AT&T to anticipate today's recision of that order on reconsideration. It would be nonsensical for this Commission to hold hearings, determine that Telpak is unlawful and order it terminated, and then reject the terminating tariff revisions because they were not accompanied by economic data supporting their lawfulness. Thus even if 47 C.F.R. § 61.38 were applicable AT&T would not have been acting unreasonably in assuming that no economic information was required with this tariff filing. Consequently we will waive 47 C.F.R. § 61.38 *sua sponte* insofar as it is applicable to the instant tariff filing. We do expect, however, that AT&T will submit to us the studies now underway to determine the impact of the termination of Telpak on other AT&T tariff offerings. Of course, if AT&T chooses to file another bulk rate offering the requirements of Section 61.38 must be fully met.

5. The stay in *Commodity News Service, Inc.* v. *FCC*

24. Paragraph 79 of our *Interim Decision and Memorandum Opinion and Order in Docket No. 19919* (Hi-Lo), 55 F.C.C. 2d 224 (1975), ordered AT&T to file "tariff schedules designed to remove the unlawful discrimination between the rates for Series 2000/3000 services and the rates for TELPAK end links specified in Series 5000. . . ." 55 F.C.C. 2d at 248. "Telpak end links" are individual circuits employed at the ends of a customer's group of Telpak circuits to terminate the numerous circuits at varying locations. Several parties who had taken advantage of the lower rates for end links filed petitions for review of that part of the Hi-Lo Order. On motion by the petitioners in that case, the United States Court of Appeals for the District of Columbia circuit

[16] *Amendment of Part 61 of the Commission's Rules, Final Report and Order*, Docket No. 18703, 25 F.C.C. 2d 957, 965 (1970).

stayed paragraph 79 pending judicial review.[17] Some petitioners in this proceeding contend that termination of Telpak violates the Court's stay.

25. We do not agree that the stay order issued by the Court of Appeals is so broad as to prohibit AT&T's termination of Telpak. The court in *Commodity News Services* is reviewing our decision that the discrimination between the rates for Series 2000/3000 services and Telpak *end links* is unlawful. The Commission in that decision did not purport to consider the lawfulness of Telpak service itself. The court was asked only to stay paragraph 79 of the Hi-Lo decision, which ordered AT&T to delete the disciminatory end link rates. The order granting the stay did not require us to forbear from deciding the lawfulness of Telpak nor prohibit AT&T from terminating Telpak on its own.[18]

26. To give the stay such a broad interpretation would mean that the Court intended to stay an action that was not before it for judicial review or on a petition for mandatory or injunctive relief. We do not believe the Court so intended. In our brief in *Commodity News Services* and in oral argument before the Court, Commission counsel informed the Court of the Docket No. 18128 decision requiring the elimination of Telpak. No suggestion was made at that time that this action was inconsistent with the stay order. We find no reason to believe this situation to have changed now that we have rescinded our Docket No. 18128 order to terminate Telpak and the tariff revisions cancelling Telpak have become carrier-initiated.[19]

6. Other arguments for rejection

27. We find that none of the other arguments advanced by the petitioners herein, in addition to those discussed above, show the tariff revisions filed with AT&T Transmittal No. 12714 to be *prima facie* unlawful. Although our Order on reconsideration in Docket No. 18128 has rescinded our requirement that Telpak be terminated by June 8, 1977, the instant tariff filing is not *prima facie* unlawful when viewed as a carrier-initiated filing. As indicated above, however, we will waive our rules to allow AT&T to withdraw the revisions before they become effective upon a proper request from AT&T.

B. Suspension and Investigation of the Proposed Revisions

28. No persuasive reason has been shown by the pleadings herein, and we find none of our own, which would prompt us to suspend or investigate these tariff revisions. The lawfulness of AT&T's rate of return on its Series 2000 and Series 3000 services is already at issue in Docket No. 20814 and has no relevance to Transmittal No. 12714. The arguments regarding prejudgment of the Petitions for Reconsideration of Docket No. 18128 and the precise obligations imposed by that decision have been mooted by today's action on the petitions. We find no

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[17] Order of November 18, 1975, in *Commodity News Services, Inc.*, v. *FCC*, Case No. 75-2057 (D.C. Cir.).

[18] In fact, in *Nader* v. *FCC*, 520 F.2d 182 (1975), the same Court ordered expedition of our decision in Docket No. 18128.

[19] Our litigation staff will inform the Court of the tariff filing which eliminates Telpak and will file any appropriate motions or suggestions with the Court.

question of lawfulness to investigate in AT&T's termination of Telpak. Our Order on reconsideration institutes an expedited investigation into the lawfulness of the current Telpak offering.

IV. *Conclusions and Summary*

29. We have found herein that the tariff revisions filed by AT&T to terminate Telpak are not *prima facie* unlawful and should not be rejected nor suspended and investigated. AT&T's actions in terminating Telpak were consistent with the requirements of our decision in Docket No. 18128, 61 F.C.C. 2d 587 (1976). For that reason we find that this tariff filing was reasonably made and, under the circumstances, we will waive Sections 61.38 and 61.58 of our Rules *sua sponte*, 47 C.F.R. §§ 61.38, 61.58, insofar as they apply. This waiver is the most equitable means of resolving the situation consistent with the public interest. Our reconsideration Order in Docket No. 18128, adopted today, has rescinded our order to terminate Telpak on June 8, 1977. In light of that rescission, we will also waive Section 61.59 of our Rules, 47 C.F.R. § 61.59, if AT&T makes a request to withdraw these tariff revisions.

30. Accordingly, IT IS ORDERED, That, the Petitions for Rejection and the Petitions for Suspension and Investigation filed against the revisions to AT&T's Tariff F.C.C. No. 260, Series 5000, accompanying AT&T Transmittal No. 12714, ARE DENIED.

31. IT IS FURTHER ORDERED, That, 47 C.F.R. § 61.38 and 61.58 ARE WAIVED insofar as they apply to these tariff revisions.

FEDERAL COMMUNICATIONS COMMISSION,
VINCENT J. MULLINS, *Secretary.*

DISSENTING STATEMENT OF COMMISSIONER ABBOTT WASHBURN

Re: ATT's Revised Charges for Private Line Services
and Termination of ATT's Telpak Bulk Private Line Service
(Transmittals #12714 and #12716)

The majority has today adopted a patchwork, result-oriented solution—one which flouts the basic requirement for justification of rate increases. Once again, the Commission has shown that it has lost control over Bell's private line tariffs.[1]

The two decisions are inextricably intertwined and must be considered as two parts of an integrated whole. Taken together the rate increase of these two actions amounts, in Bell's own words, to at least $80,000,000 per year.[2] Nevertheless, by vote of the majority, the Commission is allowing this huge increase to go into effect without a shred of cost justification or any assurance that these increased revenues will be flowed through to the public in the form of other rate reductions. Thus Bell avoids the regulatory control which this Commission is mandated to exercise over a monopolist. The majority rationalizes this by saying they are going along with it "in order to restore a semblence of order and predictability to ATT's private line offerings . . . The public must have some relief from the instability and confusion of the

[1] It is inconceivable to me that we are totally powerless under the Communications Act to protect the public from this particular form of a major rate increase.

[2] See Bell's own calculations in Transmittal 12716 pp. 8, 9, and Petition for Suspension and Investigation on behalf of the Executive Agencies of the United States Government, pp. 24, 25.

current situation."[3] Ironically, what they have done today will only serve to compound further the uncertainty and instability of private line rates.

Last September, in Docket 18128, I warned: "Until we know the outcome of these [cost] consultations it would be imprudent . . . for the Commission to order revised rate-level filings for the major categories of interstate services. . . . In so doing the Commission is stepping out in the dark. . . . Turbulence in rates appears to be a likely consequence, accompanied by uncertainty and confusion on the part of both the users and the telephone companies."[4]

In a separate action today we found it necessary to reconsider that portion of our Final Decision in Docket 18128 which ordered that Telpak be terminated on June 8, 1977. I agree with that decision.

In my judgment, the "instability and confusion of the current situation" derives directly from the Common Carrier Bureau's proclivity to revise rates in the absence of firm cost justification. But, again today, the majority of the Commission has supported the Bureau and repeated the old error, by waiving the cost justification rule and again allowing revised (in this instance higher) rates to go into effect. Once again the result is sure to be increased rate disruption and confusion. The Commission does not learn by its own mistakes, unfortunately.

I would have preferred: 1) to reconsider our decision on Telpak in Docket 18128, thereby removing any Commission requirement that Telpak be terminated on June 8, 1977; 2) since the termination of Telpak, if it becomes effective, would be carrier-initiated and result in a *de facto* rate increase, such termination should be accompanied by complete justification for rate increases as required in advance by Section 61.38 of our Rules; and 3) any replacement tariff, such as a revised MPL Series 2000/3000, for a carrier-initiated termination of Telpak should likewise be rejected unless it complies fully with the requirements of our rules.

This series of actions would effectively restore the *status quo* before our unfortunate decision in Docket 18128. Further, it would lend stability to the marketplace by assuring both the user and the telephone companies that any and all tariff changes must be accompanied by complete cost justification *prior* to acceptance by this Commission.

Accordingly, I dissent.

SEPARATE STATEMENT OF COMMISSIONER JOSEPH R. FOGARTY

Approving Order on Reconsideration in Docket No. 18128;
Dissenting to Order on Termination of AT&T Telpak Bulk Private Line Service (Transmittal No. 12714); and
Concurring in Order on AT&T Revised Charges for Series 2000/3000 Private Line Services (Transmittal No. 12716)

I cannot condone the majority's treatment of the Telpak termination filing, because, in fact, that disposition opens the door to a rate increase in the predicted amount of $80 million without any supporting cost justification.

[3] American Telephone and Telegraph Company, in Docket 20814, released today, at paragraph 22.
[4] Statement of Commissioner Abbott Washburn on Docket 18128, Concurring in part and Dissenting in part, September 23, 1976.

The initial Telpak decision in Docket No. 18128 was taken on my first meeting day as a Commissioner, and I therefore did not participate. Of course, under these circumstances, there is no sight like hindsight, but it is plain to me now that the Commission there put the cart before the horse in ordering the termination of Telpak on the ground of no showing of "competitive necessity" without first determining whether Telpak was cost-justified. In retrospect, our current predicament is traceable directly to that error which we now properly, but belatedly, are attempting to correct.

As the termination of Telpak clearly will have the effect of a substantial rate increase which now should be considered carrier-initiated, I would have required that such termination filing be accompanied by full cost justification data in accordance with Section 61.38 of the Rules. That point has been lost to the majority and we are now confronted with the imminent prospect of the withdrawal of Telpak. Therefore, I concur in the Commission's treatment of the AT&T MPL Series 2000/3000 tariff revisions so that users, AT&T, and, indeed, this Commission may have, if not certainty, then at least a modicum of order and predictability with regard to the status and availability of AT&T's private line tariff offerings.

Appendix E

Common Carrier, Rates, Charges, see also Tariff
Reconsideration, On Own Motion
Tariff, Suspension

Emergency Request for Reconsideration on the Commissions Own Motion, for reconsideration of decision (FCC 77-384) denying request for suspension of tariff revisions terminating the Telpak bulk rate offering, denied. No new arguments have been presented, nor have any new or changed facts been alleged.

F.C.C. 77-415

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of AMERICAN TELEPHONE AND TELEGRAPH COMPANY, LONG LINES DEPARTMENT Revisions to Tariff F.C.C. Nos. 258 and 260 (Series 5000)—Termination of Telpak Service	Transmittal No. 12714

MEMORANDUM OPINION AND ORDER

(Adopted: June 13, 1977; Released: June 15, 1977)

BY THE COMMISSION: COMMISSIONERS HOOKS AND WASHBURN DISSENTING: COMMISSIONER FOGARTY ABSENT.

1. On June 2, 1977, we adopted a Memorandum Opinion and Order, FCC 77-384, which denied Petitions for Suspension of the above-captioned tariff filing. We now have before us an "Emergency Request for Reconsideration on the Commission's Own Motion" filed June 7, 1977, by Aeronautical Radio, Inc. (ARINC). The petition requests that we reconsider our decision denying the request for suspension of the tariff revisions terminating the Telpak bulk rate offering.

2. ARINC's petition offers no arguments not previously considered in our disposition of the Petitions for Suspension, nor have any new or changed facts been alleged. Consequently, ARINC has shown no basis for reconsideration of our prior denial of the Petitions for Suspension of the above-captioned tariff filing.

3. Accordingly, IT IS ORDERED, That, the Emergency Request for Reconsideration on the Commission's Own Motion, filed June 7, 1977, by Aeronautical Radio, Inc. IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION,
VINCENT J. MULLINS, *Secretary*.

Appendix F

Common Carrier, Rates, Charges, see also Tariff
Tariff, Suspension
Telpak

Petition for Reconsideration of Commission decision (FCC 77-384) not to suspend tariff revision terminating Telpak, denied.

F.C.C. 77-423

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
AMERICAN TELEPHONE AND TELEGRAPH COMPANY, LONG LINES DEPARTMENT	Transmittal No. 12714
Revisions to Tariff F.C.C. Nos. 258 and 260 (Series 5000)—Termination of Telpak	Transmittal No. 12765

MEMORANDUM OPINION AND ORDER

(Adopted: June 16, 1977; Released: June 20, 1977)

BY THE COMMISSION: COMMISSIONER HOOKS DISSENTING: COMMISSIONERS WASHBURN AND FOGARTY ABSENT.

1. We here consider two motions filed on behalf of the General Electric Company (G.E.) in the above-captioned matter. The motions, filed June 14, 1977, are entitled "Motion for Expedited Interim Action" and "Petition for Reconsideration, Extension of Section 203 Notice, and Suspension." These motions ask that this Commission reconsider our decision, released June 13, 1977, not to suspend tariff revisions cancelling the Telpak offering. FCC 77-384. Telpak is a bulk rate offering of private line communications service offered to the public by the American Telephone and Telegraph Company, Long Lines Department (AT&T) in its Tariffs F.C.C. Nos. 258 and 260. The termination of Telpak is currently scheduled for June 21, 1977.

2. In its Motion for Expedited Interim Action, G.E. requests that we postpone the effective date of the tariff revisions terminating Telpak until we reconsider our June 13, 1977 decision not to suspend those tariff revisions. FCC 77-384. G.E. proposes that we accomplish such a postponement by "using [our] tariff suspension authority under Section 204 of the Communications Act, or other appropriate authority."

3. We conclude that Section 204 of the Communications Act, 47 U.S.C. § 204, does not provide for suspension of tariff filings pending a Commission decision on whether or not to investigate the tariff filing. Likewise Section 204 does not permit suspension pending reconsideration of such a decision. Thus we find that Section 204 cannot be used to hold in abeyance the effective date of the above-captioned tariff filings for the purpose sought by G.E. herein. Since no hearing has been designated to investigate the lawfulness of these tariff filings suspension is inappropriate under Section 204.

4. Section 203(b)(2), 47 U.S.C. § 203(b)(2),[1] of the Act states that "the Commission may not require the notice period [for a tariff filing] to be more than ninety days." The tariff revisions terminating Telpak were filed March 23, 1977, with Transmittal No. 12714; ninety days from that date is June 21, 1977. AT&T's Transmittal No. 12765 was filed June 6, 1977, and accompanied tariff revisions which extend the scheduled effective date of the termination of Telpak from June 8, 1977, to June 21, 1977.[2] G.E. maintains that we can require the Transmittal No. 12765 tariff revisions filed June 6 to be extended to a full ninety days' notice and thereby concurrently postpone the termination of Telpak beyond June 21. This argument is erroneous. The revisions with Transmittal No. 12765 did not cancel Telpak, they merely postponed the effective date of the cancellation from June 8 to June 21. If the deferring revisions were not effective on June 8, 1977, the Telpak tariff would have terminated at that time. Any suspension or rejection of those revisions would merely prevent the extension of the terminating date from June 8 to June 21, it would not prevent Telpak's termination on June 21. Nor do we find any other means to hold the Telpak termination in abeyance pending a decision on the Petition for Reconsideration. In light of the foregoing discussion, we conclude that we cannot grant G.E.'s request to hold the effectiveness of the Telpak termination in abeyance beyond June 21, 1977, pending action on G.E.'s Petition for Reconsideration, Extension of Section 203 Notice, and Suspension.

5. G.E. puts forth the following three arguments in favor of reconsideration of our denial of its Petition for Suspension of the tariff revisions accompanying AT&T Transmittal No. 12714: (1) our conclusion that Section 214 authorization is not a condition precedent to the termination of Telpak should be reviewed; (2) termination of Telpak constitutes a rate increase requiring 90 days' notice, 47 C.F.R. § 61.58, and economic support information, 47 C.F.R. § 61.38; and (3) failure to act prior to the effective date of the tariff effectively will deny G.E.'s right to seek reconsideration of our decision. 47 U.S.C. § 405.

6. Upon consideration of these pleadings we see no basis to reconsider our earlier decision, FCC 77-384. G.E. has alleged no new facts or errors in our decision which would prompt us to reconsider.

7. Accordingly, IT IS ORDERED, That G.E.'s "Petition for Reconsideration, Extension of Section 203 Notice, and Suspension," filed June 14, 1977, in the above-captioned matter IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION,
VINCENT J. MULLINS, *Secretary.*

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[1] As amended, Pub. L. No. 94-376, § 2(b)(2) (Aug. 4, 1976), 90 Stat. 1080.
[2] Filed pursuant to F.C.C. Special Permission No. 8390.

Appendix G

Common Carrier, Costs, Allocation Of
Common Carrier, Rates, Just And Reasonable Charges
FCC Jurisdiction, see also Forum
Telephone Rates
TELPAK
Wide Area Telephone Service

Commission is mandated by Communications Act to determine appropriate costing methods to set telephone service return levels; non-cost factors also noted. Fully distributed costs, not long-run incremental costs, used to determine justness of rate levels.

F.C.C. 76-886

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of AMERICAN TELEPHONE & TELEGRAPH COMPANY, LONG LINES DEPARTMENT Revisions of Tariff FCC No. 260 Private Line Services, Series 5000 (TELPAK)	Docket No. 18128

MEMORANDUM OPINION AND ORDER

(Adopted: September 23, 1976; Released: October 1, 1976)

BY THE COMMISSION: CHAIRMAN WILEY ISSUING SEPARATE VIEWS; COMMISSIONER HOOKS DISSENTING AND ISSUING A STATEMENT; COMMISSIONER WASHBURN CONCURRING IN PART AND DISSENTING IN PART AND ISSUING A STATEMENT; COMMISSIONER FOGARTY NOT PARTICIPATING.

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Key to Reference Abbreviations

Brief	Br.
Brief in Reply to Exceptions	BRE
Brief in Support of Exceptions	BSE
Exhibit	Exh.
Exception(s)	Expt.
Page	p.
Paragraph	par.
Paragraphs	pars.
Proposed Findings	P.F.
Pages	pp.
Reply to Exceptions	RE
Transcript	T.

I. INTRODUCTION AND SUMMARY

1. The issues involved in this proceeding can be traced to the early 1960's with the inception of Docket 14251 (the original TELPAK investigation) and Docket 14650 (an inquiry into Western Union's domestic telegraph and other services). Docket 18128 originally concerned the lawfulness of TELPAK rate increases of March 25, 1968. However, through consolidation of certain issues extant in Docket 16258 (which concerned appropriate interstate service revenue contributions) and Docket 18684 (which concerned revised video transmission rates), the scope of this proceeding now includes the issue of the general lawfulness of overall rate levels [1] and interservice rate level relationships of Bell's major categories of interstate service. (Findings in this proceeding apply to those services of Western Union which exhibit matching rate levels.) Implicit in the determination of appropriate earnings relationships of Bell's services is our parallel determination of the proper methodology by which each service's contribution to total earnings is to be measured.

2. It is Bell's position that each category of service should yield revenues, at a minimum, to cover its forward looking, long-run incremental costs (LRIC). Actual rates should exceed such minimums so that aggregate revenues from all services yield the overall interstate revenue requirement. Bell has employed a "basic service philosophy" with regard to determining how total revenue requirements are to be recovered by its private line and monopoly services (MTS and WATS). That is, private line service rates are to yield an "optimum" contribution to earnings above minimum LRIC levels. MTS and WATS rates

[1] "Rate levels" and "return levels" are generally used interchangeably herein.

are to cover residual revenue requirements not met by private line service revenues. Bell has proposed an incremental, prospective "burden test" allegedly to show that its rates are free from cross-subsidization, and a "retrospective accountability" test for purposes of providing comparative information concerning forecast and actual results.

3. The Chief of the Common Carrier Bureau released a Recommended Decision (RD) herein on January 19, 1976. The case is before us on exceptions filed to the RD. The RD did not accept Bell's LRIC-oriented basic service philosophy, but supported Fully Distributed Costs (FDC) Method 1 to determine each service's relevant costs. The RD relied on individual service deviations from the Method 1 computed return on investment as an indication of the existence of cross-subsidization and to determine the lawfulness of rate levels and rate level relationships. (The RD held that MTS rates should be designed so as to yield earnings no more than the lesser of Bell's maximum allowed rate of return, or the overall rate of return actually being realized. Private line categories of service rates should be designed to yield no less than the minimum allowable overall rate of return.)

4. We find it encumbent to select the costing methodology which best reflects our statutory mandate (see Section VIII). Our prior policy supports the position that actual costs of providing service underlie the statutory requirement that rates be just, reasonable, and nondiscriminatory, albeit this does not mean that costs are the *only* criterion useful in determining whether rates are lawful under the Act. Further, we conclude that the public interest is not generally served by interservice cross-subsidization, but recognize that statutory and social policies may lend sanction to some intraservice subsidies. Finally, we make findings regarding proper cost standards, measures of cross-subsidization, and acceptable departures from cost of service as a criterion of the justness and reasonableness of return levels and relationships.

5. We hold that Bell's use of LRIC and, generally, its basic service philosophy do not satisfy the constructs of true marginal cost pricing principles. Indeed, we note that it is not possible to make a strict translation from neoclassical marginal costing theory to the pragmatic world of telecommunications. On the basis of these determinations, we have concluded that no "optimal" social welfare or beneficial public interest characteristics could be imputed to Bell's costing methodology. To the contrary, we find Bell's basic service philosophy merely a variant of a full costing approach.

6. We determine that an FDC costing approach is most consistent with our objectives and responsibilities under the Act, and should be the basic standard by which the justness and reasonableness of rates will be judged. Of the seven FDC methods of record, Method 7's historical cost causation basis of allocating costs is determined to be most consistent with our mandate to ensure just, reasonable, and nondiscriminatory rates. However, we recognize that such factors as demand fluctuations and varying growth patterns between services could cause distortions between historical causation and actual cost patterns. For this reason, we require that revised Method 1 data be filed concurrent with that of revised Method 7 to document comparative current relative use cost patterns, and to establish the veracity of the cost patterns determined under the historical cost causation approach. Revisions are found to be necessary in the case of both Method 1 and Method 7 to

correct certain infirmities in these methods as they have previously been implemented. These revisions are to be made before these methods are used as the basis of revised interstate rates, supportive data for subsequent rate changes, or continuing surveillance.

7. We find that Method 1 and Method 7, full cost data currently available from the record provide an adequate "zone of reasonableness" for purposes of drawing conclusions concerning the lawfulness of Bell's past and present rate levels. On the basis of a zone of reasonableness defined by Method 1 and Method 7 data, we find the current MTS return level lawful under Section 201(b), and that since 1969, at least, MTS has earned a level of return that has not been unduly excessive. Present WATS return levels appear, on the data in this record, excessive and indicative of the presence of cross-subsidization. Past WATS levels of return likewise appear excessive, inclusive of the period from the Seven-Way Cost Study (1964) to the present. However, as we note below, we are uncertain as to the actual costs of providing WATS and will await a refiling and cost justification of new WATS rates in accordance with our recent *WATS* decision. We also find that the present return levels for Bell's other services (Private Line Telephone, Private Line Telegraph, Audio/Radio, Television, and the "Other" service classifications) are deficient, and, as such, are being subsidized by other services. Past return levels for these services are generally also found to have been unlawfully low, although in some years the return level of certain services could have been considered to have approached the zone of reasonableness.

8. We have investigated the lawfulness of Bell's rate levels for its interstate services under Section 202(a). Consistent with the Commission's TELPAK decision we find that the RD correctly recognized that competitive necessity may justify what might otherwise be considered as unlawfully discriminatory rates. However, we disagree with the RD's conclusion, relying on the *Telpak Sharing* proceeding, that discriminatory pricing based on competitive necessity is permissible only if the carrier meets the three criteria enunciated in that proceeding. We also depart from the RD by concluding that the competitive necessity criteria need not be applied to *all* Private Line Services.

9. We find that only two of the three competitive necessity criteria are pertinent and should be applied to Bell's TELPAK offering to determine if there are violations of Section 202(a): (1) that those benefitting from the discrimination have an alternative supply source which will be utilized in the absence of discrimination and, (2) that the discrimination benefits users discriminated against. We find the record shows that the threat from private microwave and indeed from competing terrestrial and satellite carriers has not and still does not warrant the extent of discrimination manifested by Bell in its TELPAK category of service. There has been no showing that this specific TELPAK bulk rate response is commensurate with any *real* competitive threat. Nevertheless, we recognize that a bulk rate offering of some other nature and magnitude may be warranted. We therefore order Bell to refile its TELPAK offering.

10. Under our guidelines, we direct Bell to assign all extant facilities to its services to provide a facility "datum." Such a datum will provide the distributive basis for related cost assignments, and will ensure

carrier accountability and non-discriminatory treatment of all users. Nevertheless, we conclude that certain demand and supply conditions may warrant the offering of less than full cost ("discount") rates. This might be permissible if the carrier can make a definitive and clear showing of recovery of full recorded costs by the service involved within a reasonable time certain, and if such departures are in the public interest and consistent with the Commission's basic mandate. Further, we have directed Bell to develop acceptable forecasting techniques in conjunction with the Bureau Staff for use in Method 7 procedures, and that the Staff, in consultation with Bell, revise Method 7 and Method 1 procedures to correct certain infirmities. These revisions will permit the use of these methods as the foundation of our basic evaluative procedures. Finally, we direct the staff to complete the methodological revisions within three months, and, direct Bell to file rates for all its services based on a revised Method 7 analysis (supplemented by revised Method 1 data) within eight months, both from the effective date of this order.

II. HISTORY OF THE PROCEEDINGS

11. This docket is an outgrowth and consolidation of several significant and complex proceedings before the Commission over the past fifteen years. Consequently, we believe it helpful to present an abridged case history to facilitate an understanding of its evolution. We note that the RD contains a more elaborate history.

12. On September 7, 1961, we instituted Docket No. 14251, an investigation into Bell's original TELPAK tariff.[2] TELPAK, a bulk private line offering, was filed in anticipation of competition from private microwave arising from our *Above 890* decision.[3] On March 18, 1964, we issued our Tentative Decision in Docket 14251, concluding that:

(a) Services furnished under the TELPAK tariff and those furnished under the various other private line tariffs are like communications services.

(b) There are no material cost differences attributable to furnishing a number of channels of one customer under TELPAK as opposed to furnishing the same number of channels to several customers under the other private line tariffs.

(c) There is no justification for TELPAK A and TELPAK B in terms of competitive necessity, inasmuch as the rates for the equivalent number of channels offered under ordinary private line tariffs are reasonably competitive with the costs of private microwave systems.

(d) There is apparent justification for TELPAK C and D classifications in terms of meeting competition from private microwave systems having channel capacities comparable to those offered by such TELPAK classifications. However, we are unable to determine on this record that the rates for TELPAK C and D classifications are compensatory in relation to the costs of furnishing the services offered thereunder, and

[2] FCC 61 1039 (1961).
[3] 27 FCC 359 (1959), *reconsideration denied*, 29 FCC 825 (1960).

> therefore are unable to find that the other users of AT&T services will benefit and not be burdened by the application of such rates.[4]

We affirmed these conclusions by a final decision, adopted December 23, 1964. However, we held that the record should be reopened to allow Bell to furnish probative cost data showing that the TELPAK C (60 voice-grade channels)[5] and TELPAK D (240 voice-grade channels) offerings are compensatory and do not burden other users of Bell's services. We ordered Bell to file tariffs to eliminate the unlawful discrimination found to exist between TELPAK A (12 voice-grade channels) and TELPAK B (24 voice-grade channels) and private line rates.[6]

13. In 1962, while the *Telpak* proceeding was underway, we instituted Docket No. 14650, a broad inquiry into Western Union's domestic telegraph and other services.[7] In response to allegations by Western Union that Bell had historically used its monopoly voice services, to subsidize its competitive services, the Commission's Telephone and Telegraph Committees requested Bell to perform a study to ascertain Bell's interstate investment, revenues, and expenses, and net earnings among its seven categories of service: MTS, wide area telephone service (WATS), teletypewriter exchange service (TWX), private line telephone service, private line telegraph service, TELPAK, and all others.[8]

14. Bell submitted study results known as the "Seven-Way Cost Study," on September 10, 1965. The study showed that for the twelve month period ending August 31, 1964, the return on Bell's investment ranged from 10.1% for WATS to 0.3% for TELPAK. Further, Bell's return on its competitive services were significantly below its system-wide average, while its return on monopoly services, MTS and WATS, were above the average.[9] However, the Commission did not address the questions of compensativeness and cross-subsidy in Docket 14650.

15. As a result, in part, of the Seven-Way Cost Study we instituted Docket No. 16258 on October 27, 1965.[10] This proceeding was a general investigation into the rate levels and rate level relationships existing with respect to Bell's interstate services. We noted the importance of such investigation, stating that:

> Certain of the services involved are furnished by the Bell System in direct competition with services offered by other carriers. To the extent that these services may be underpriced by the Bell System, this may have a competitive impact on such other carriers.[11]

16. Following affirmation of our *Telpak* decision,[12] we terminated Docket No. 14251 and amended our designation order in Docket No.

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[4] 38 FCC 270, 395 (1964).

[5] The bandwidth of a single voice-grade channel is generally regarded as 4 kHz.

[6] 37 FCC 1111, 1117-1118 (1964), *aff'd sub nom., American Trucking Assn. v. FCC*, 377 F.2d 121 (1966), *cert. denied*, 386 U.S. 943 (1967).

[7] FCC 62-533.

[8] Report of the Telephone and Telegraph Committees in the Domestic Telegraph Investigation, Docket No. 14650, p. 200.

[9] *Id.* at 200-204.

[10] 2 FCC 2d 871 (1965).

[11] *Id.* at 872.

[12] *American Trucking Assn. v. FCC*, 377 F.2d 121 (1966), *cert. denied* 396 U.S. 943 (1967).

16258 to include the issue of whether TELPAK C and D were compensatory. We ordered the record in Docket No. 14251 incorporated by reference into Docket No. 16258. We also stressed that if Bell were to submit additional tariff filings with respect to its TELPAK offerings, such filings should be examined in a separate proceeding, not as a part of the general issues of Docket No. 16258.[13]

17. On March 25, 1968, Bell filed certain rate increases in its interstate private line TELPAK tariffs. By Order adopted April 10, 1968, we suspended such revised tariffs for the statutory period and instituted Docket No. 18128, an investigation into the lawfulness of the tariff increases.[14] By subsequent Order, adopted July 10, 1968, we further delineated the scope of this proceeding, distinguishing it from those issues in Docket No. 16258 (then designated as Phase 1-B) which was to establish a basis for the formulation of principles to govern the establishment and maintenance of overall rate levels for each of Bell's interstate services.[15] Additionally, we broadened the issues herein:

> Because TELPAK service is, in essence, a rate classification within the family of private line services offered by (Bell) appropriate consideration of the reasonableness of TELPAK rates requires simultaneous and coordinate consideration of respondents' private line tariffs. Accordingly, our Order herein will specify the issues in Docket No. 18128 to embrace all of the private line tariffs, except audio and video program transmission services, but including the charges for teletypewriter station equipment.[16]

Thus, while Docket No. 16258 was concerned with the general issue of the appropriate revenue contribution to be made by each interstate service to the overall revenue requirement, Docket No. 18128 was concerned with the lawfulness under Section 201(b) and 202(a) of the Act of each private line category, except audio and video. Additionally, at that time we imposed an accounting order and held the hearings in Docket No. 18128 in abeyance, pending the determination in Docket No. 16258 of appropriate ratemaking principles and resolution of the TELPAK sharing proceedings in Docket No. 17457.[17] Finally, the scope of this proceeding was broadened by further Order of the Commission on July 24, 1968, suspending tariff rate increases for Western Union's teleprinter station equipment. The issues related to the lawfulness of AT&T's rates were found applicable to Western Union's rates.[18]

18. As Docket No. 16258 proceeded, the Commission, acting through its Telephone Committee, initiated conferences among the parties in order "to facilitate the possibility of resolution of some or all of the pending issues by mutual agreement."[19] As a result of these conferences, the parties and the Chief, Common Carrier Bureau agreed to a "Statement of Ratemaking Principles and Factors." This "Statement," which was issued on May 28, 1969, declared certain ratemaking principles and factors to be acceptable to the parties and the Bureau.[20] It

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[13] 7 FCC 2d 30, 31 (1965); 6 FCC 2d 177, 180 (1966).
[14] FCC 68-388 (1968).
[15] 13 FCC 2d 853, 855 (1968).
[16] *Id.* at 857.
[17] *Ibid.*
[18] FCC 68-756 (1968).
[19] FCC 69M-197 (1969).
[20] Docket No. 16258, T. 22329-22341; 18 FCC 2d 761, 765-769 (1969).

also suggested procedures to effectuate the ratemaking principles, including new studies to be made by AT&T, and possible rate changes, in conformity therewith. On July 29, 1969, we took note of the "Statement," without necessarily approving it, and adopted the recommended procedures except for the recommendation that the *Telpak Sharing* proceeding be reopened and consolidated with the proceedings herein. At the same time, we incorporated the record of Phase 1-B of Docket No. 16258, including the record of the original *Telpak* proceeding, Docket No. 14251, into this docket.[21] Thus, by July 1969, Docket 18128 had grown from the original investigation into the lawfulness of TELPAK rate increases to a general investigation of AT&T's and Western Union's private line tariffs, other than program transmission services, including issues as to the overall revenue contribution that should be made by each service and whether TELPAK C and D were compensatory.

19. As a result of the "Statement of Ratemaking Principles and Factors," Bell filed new proposed TELPAK tariff rate increases on October 1, 1969, based on updated studies. On October 29, 1969, these tariffs were suspended and set for hearing in this proceeding.[22] Additionally, we directed that the hearings herein be removed from deferred status and that they proceed as expeditiously as possible. Western Union matched AT&T's TELPAK increases; these rates were also suspended and set for hearing herein.[23]

20. On February 18, 1970, Phase 1-B of Docket No. 16258 was procedurally terminated. However, we stated that the various rate revisions made by Bell, allegedly in conformity with the "Statement of Ratemaking Principles," and the lawfulness of the rate levels of each of AT&T's service categories including MTS and WATS, would be reviewed in the context of this proceeding and in Docket No. 18684.[24]

21. Docket No. 18684 was instituted on September 24, 1969 as an investigation into the lawfulness of AT&T's revised video transmission rates.[25] Bell also filed revised tariffs on September 25, 1969, for its audio program transmission service. These too, were set for hearing in Docket No. 18684.[26] Through informal conferences the issues concerning the audio services were resolved.[27] However, the lawfulness of the video private line services continued unresolved. On June 10, 1970, we consolidated Docket No. 18684 with this proceeding in order to "view the totality of costs for all of AT&T's interstate services so that the question of interstate burden can be examined and if necessary corrected. . . ."[28] Hearings commenced on September 28, 1970 following three prehearing conferences.

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[21] 18 FCC 2d 761, 763-764 (1969).

[22] 20 FCC 2d 383, 388 (1969), *petitions for reconsideration denied*, 21 FCC 2d (1970). We also set for hearing Bell's Series 11000 wideband service. This service was terminated on May 1, 1973. On Petition for Review, the United States Court of Appeals for the District of Columbia Circuit affirmed our decision not to reject the TELPAK increases. *Associated Press* v. *FCC*, 448 F.2d 1095 (D.C. Cir. 1971).

[23] FCC 69-1345 (1969).

[24] 21 FCC 2d 495, 496-497 (1970).

[25] FCC 69-1038 (1969).

[26] FCC 69-1197 (1969).

[27] See Orders of the Examiner, FCC 70-M-808, June 5, 1970, and FCC 70-M-941, July 1, 1970.

[28] 23 FCC 2d 503, 509. By this Order we also denied various petitions for reconsideration of our February 18, 1970 action which included the lawfulness of the rate levels of all of Bell's major services as an issue herein. 23 FCC 2d at 507.

22. On November 20, 1970, AT&T filed tariffs designed to increase rates for MTS in order to achieve a higher overall return on total investment. At our request, Bell postponed the effectiveness of these tariff revisions pending an expedited rate hearing. As an interim measure the Commission granted special permission to AT&T to file lesser rate increases. These were suspended and set for hearing with an accounting order in Docket No. 19129.[29] However, certain of the issues raised by the MTS rate increases were designated as issues to be determined herein. In particular, Bell was required to show that its claimed additional interstate revenue requirement should be met solely through increased charges to the MTS customer and further that the rate increases at issue in Docket No. 19129 did not involve cross-subsidization of any other service.[30]

23. On December 6, 1971, AT&T filed revised private line tariffs, increasing rates for TELPAK and private line telephone and telegraph services. These increases were suspended and the lawfulness of the revision designated for hearing in this proceeding.[31] Similar increased rates filed by Western Union were also placed in issue in this Docket.[32]

24. Bell also sought to revise its video program transmission tariffs. By Memorandum Opinion and Order released May 15, 1973, we designated aspects of the video tariff revision for oral argument on July 26, 1973, in Docket 18684.[33] Oral argument was held, after which the Chief of the Common Carrier Bureau held a number of settlement conferences with the parties. By stipulation signed November 27, 1973, the participants agreed to a two year experimental period during which certain stipulated rates and conditions would apply to video private line service. We approved this stipulation and terminated Docket No. 18684 on December 11, 1973.[34] However, although the rate structure issue in Docket No. 18684 is now moot, the issue of the rate level for the video program transmission service remains at issue herein.

25. Evidentiary hearings herein began on September 28, 1970 and were concluded on August 8, 1972. Fifty-three witnesses presented testimony and evidence. There are now approximately 27,000 pages of transcript and exhibits before us in this docket alone, in addition to the record from Docket 16258. The Administrative Law Judges closed the record herein on December 11, 1972.[35] Proposed Finding of Facts and Conclusions were filed on March 12, 1973 and Replies thereto on May 14, 1973. The Recommended Decision of the Chief, Common Carrier Bureau was released on January 19, 1976. The parties' Exceptions and Supporting Briefs were submitted one month later. We entertained oral argument on July 14, 1976.

III. ISSUES TO BE RESOLVED

26. As can be seen from the preceding summary of the history of this case, our present questions as to the legality of rate levels and rate level relationships arose initially from tariff submissions in Docket 18128 (with respect to the private line offerings of Bell and

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[29] 27 FCC 2d 149 (1971).
[30] 27 FCC 2d 151, 156-157 (1971). AT&T later agreed to consider further rate increases for services other than MTS subject to final determination in Docket No. 18128. 30 FCC 2d 503 (1971).
[31] 33 FCC 2d 522 (1972).
[32] 34 FCC 2d 839 (1972).
[33] 40 FCC 2d 901 (1973), *rev'd in part, AT&T* v. *FCC*, 487 F.2d 864 (2d Cir. 1973).
[34] 44 FCC 2d 525 (1973).
[35] FCC 72M-1528.

Western Union), in Docket 18684 (with respect to Bell's Audio and Television Program Transmission Services) and in Docket 19129 (with respect to MTS). As originally designated, the questions of lawfulness of these tariff submissions included not only a consideration of the rate levels of each service category, but also an examination of the internal rate structure of each such service category in light of the statutory language of Sections 201-205 of the Act. As the RD recognized, however, the broad inquiry into the lawfulness of the tariffs in this proceeding was subsequently narrowed.[36] Thus, in Docket Nos. 19129 and 18684, we ruled that the MTS, WATS and Audio/Video tariffs were to be considered herein, but only insofar as the lawfulness of the rate levels of each such class of service was concerned.[37] We have stated that this proceeding is to resolve the fundamental and important question:

> What should be the appropriate earnings relationship among the various interstate services offered by the Bell System? And, *how should the contribution to total earnings by each service be measured?* (33 FCC 2d 522, 524) (Emphasis added.)

27. We thus have before us the lawfulness of overall rate levels and the lawfulness of interservice rate level relationships with respect to the following interstate categories of service offered by Bell:

—Private Line Telephone Service
—Private Line Audio Program Transmission Service
—Private Line Television Program Transmission Service (Video)
—TELPAK Service
—Private Line Teletypewriter Service (Private Line Telegraph)
—Long Distance Message Telecommunications Service (MTS)
—Wide Area Telecommunications Service (WATS)

and the following categories of service offered by Western Union:

—Leased Line Telegraph Service
—Leased Line Telephone Service
—Leased Line Telpak (Broadband) Service
—Telpak Bulk Rates for Leased Line Telephone & Telegraph Service

In statutory terms we have stated the issues herein as follows:

(a) Whether the rate levels for (1) message toll telephone service, (2) WATS, (3) private line telephone grade service, (4) private line telegraph grade service, (5) audio and video program transmission services, (6) TWX and (7) all other services are or will be just and reasonable within the meaning of Section 201(b) of the Communications Act of 1934.
(b) Whether the rate levels for the above-mentioned services will subject any person or class of persons to unjust or unreasonable discrimination, or give any undue or unreasonable prefer-

[36] Exceptions have been raised with respect to the RD's failure to reach the lawfulness of various rate structure elements. Insofar as we agree with the RD that the issues herein were narrowed to encompass only return levels and inter-service return level relationships, we do not address any rate structure questions. Furthermore, because the parties have addressed themselves almost entirely to return level issues, the record herein is inadequate to make any findings with respect to rate structure.

[37] *See also* 34 FCC 2d 839, 840 (1972).

ence or advantage to any person, class of persons or locality, or subject any person, class of persons or locality to any undue or unreasonable prejudice or disadvantage within the meaning of Section 202(a) of the Communications Act of 1934.

(c) Whether the Commission should prescribe just and reasonable rate levels with respect to any or all of the above-mentioned services placed at issue by this order, and, if so, what rate levels should be prescribed. (21 FCC 2d 495, 497.)

Thus, in summary, we are concerned herein with the lawfulness of rate levels, interservice rate level relationships and with the appropriate basis for measuring same.

28. The RD proposed (par. 36) that ten questions be addressed in resolving the fundamental issues discussed above.[38] Bell, the Airlines, ARINC, and the Ad Hoc Telecommunications Committee[39] object to one or more of these questions. They argue that the questions do not fairly reflect the issues herein or that the questions assume answers to issues yet to be resolved. To the contrary, we believe that in general these questions do reflect the issues herein. However, while our resolution of the issues will, of necessity, provide answers to these questions, we do not intend to limit our discussion below to only these.

29. Western Union, Bell, and AIA except to the RD's failure to address the question of the propriety of Western Union's rate levels. The RD concluded that the Commission need only be concerned in this proceeding with the rate levels of Bell's service classifications. We agree with the RD that the primary purpose of this proceeding is to focus on Bell's offerings and that an in depth analysis of the lawfulness of Western Union's rate levels would unduly complicate this already complex and protracted proceeding, with no concomitant benefit. The

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[38] These questions are:

(1) Whether and to what extent there is or will be any cross-subsidization among the aforementioned eight principle interstate service and rate categories of Bell;

(2) Whether and to what extent the "Long Run Incremental Cost" (LRIC), "burden test," and the "retrospective accountability" approaches and principles as proposed by Bell herein, are appropriate as a basis for the pricing of their services;

(3) Whether and to what extent the "Fully Distributed Cost" (FDC) principles, as proposed by certain parties, should be used as a basis for the pricing of these services;

(4) Whether and to what extent Bell should be permitted to earn in excess of its overall allowable interstate fair rate of return (currently 9.5%-10.0%) on investment allocated on an FDC basis to its monopoly MTS and WATS services;

(5) Whether and under what circumstances Bell should be permitted to price its competitive private line services individually, or as a group, at less than the interstate fair rate of return on its investment allocated on an FDC basis to such services;

(6) Whether the past and present disparities in the levels of bulk TELPAK and non-TELPAK rates for like Private Line Telephone and Telegraph Services constitute undue discrimination or preference in violation of Section 202(a) of the Act;

(7) Whether and to what extent the past and present overall levels of Bell's bulk TELPAK rates for ordinary Private Line Telephone and Telegraph Services are now or have been noncompensatory or otherwise unjust and unreasonable under Section 201(b) of the Act;

(8) Whether and to what extent the various tariff filings revising the rate levels for Private Line Telephone, Private Line Telegraph, Private Line Audio, TELPAK Broadband, Private Line Video Program Transmission Services, and TELPAK bulk rates have been justified by Bell;

(9) Whether and to what extent Bell's pricing practices with respect to the level of rates for its principal categories of service derogate against the regulatory policies and objectives of the Commission as set forth in its *Specialized Common Carrier* decision in Docket No. 18920; and

(10) Whether and to what extent the Commission should order revisions to be made in the rate levels of MTS, WATS, or of Bell's other principal categories of service in the light of the findings and conclusions reached on the above-stated issues.

[39] These and other parties are identified in Section IV, *infra*.

record shows that Western Union's rate levels for its leased line and TELPAK services were based solely to be competitive with Bell's service offerings and that Western Union has neither adopted Bell's theory of ratemaking at issue herein nor supported the claim that Bell's rate levels are lawful. Thus, to the extent we find Bell's rate levels unlawful, we cannot find lawful the matching rate levels of Western Union. With regard to its prior filings, it is clear that Western Union's increases in its TELPAK and private line rates were justified and that no refunds would therefore be due. Accordingly, we are terminating the accounting orders issued herein with respect to Western Union's services.

IV. BASIC POSITIONS OF THE PARTIES[40]

Bell System Respondents (Bell or AT&T)

30. We find that the Bell System fairly characterized its position in summary form in its Proposed Findings of Fact and Conclusions (pars. 1-17) and in its Exceptions to the RD (Bell Expt., pp. 25-27). The Bell System maintains that it seeks to obtain revenues from all its interstate services sufficient to meet its total interstate revenue requirement. It notes that each category of service should yield revenues to cover the costs incurred in furnishing the service, including the cost of capital, and in addition to make a contribution toward the coverage of common costs. Bell maintains that the relevant costs to be considered are long-run incremental costs (LRIC), not fully allocated or fully distributed costs. Bell stated that its LRIC studies "represent the full amount of the effect on the total cost to the firm resulting from a difference in one level of output compared with another level of output." (T. 2237.) Bell maintains that although costs play an essential role in determining rate levels, rates cannot be based solely on costs. Incremental costs determine the minimum rates for a service category. Actual rates should exceed such minimums so that the aggregate revenues from all services yield the overall interstate revenue requirement.

31. In pricing its private line services, Bell states that it seeks to establish rate levels which are competitively effective and yield an "optimum" contribution to earnings. Bell notes that its objective is to keep MTS charges as low as possible and still meet its interstate revenue requirement. Relevant ratemaking factors such as market conditions and rate relationships may lead Bell to choose an "optimum" rate which does not make the maximum possible contribution. MTS and WATS rates are set to cover the portion of the overall revenue requirement not met by private line service revenues. "Contribution" from a service is defined as the difference between the service's total revenues and its incremental costs, counting, where appropriate, cost savings and revenues foregone. This, defines what we term Bell's "basic service" philosophy.

32. In comparing alternative rate proposals, Bell maintains the basis of comparison should be forward looking LRIC and long-run incremental revenues. Such analyses should account for any material cross-

[40] The following parties have filed Proposed Findings of Fact and Conclusions of Law in this proceeding.

elastic effects. Bell proposes a "burden test" to determine the existence of cross-subsidy. The burden test is performed as an incremental analysis which contemplates comparison between total overall costs and revenues with the service included and the total costs and revenues with the same service excluded. Bell claims that the burden test demonstrates that none of its private line services are burdening the users of MTS or any other service and that significant contributions are being made to its total revenue requirements by such services. Thus, Bell asserts that no service is cross-subsidizing any other service. Bell further claims that LRIC, the burden test and its "retrospective accountability" test (which will be described below) give the Commission a totality of information which will allow it to approve rates and monitor results. Bell contends that fully distributed cost studies used for ratemaking purposes do not provide a relevant measure of cross-subsidy or service rate levels. Thus Bell argues that the method proposed in the RD is anti-competitive and creates a protective umbrella for its competitors.

33. Bell claims that TELPAK is justified by competitive necessity and is compensatory and not a burden on MTS or any other service category. The rates under investigation are said not to be unjust, unreasonable, unlawful nor excessive and that such rates yield optimum contributions to earnings. Finally, Bell asserts that no basis has been shown for prescription by the Commission of any rates or regulations under Section 205 of the Act, and that there is no need to order refunds with respect to any rates under investigation herein which have been subject to accounting orders and possible refund.

The Airline Industry Parties (Airlines)

34. The Airlines agree that there should be no cross-subsidization, but they contend that it is neither necessary nor desirable for Bell to maintain the same relationships between revenues and costs, or the same rate of return, for each class of service. They note that cost-indicated rates are useful ratemaking tools. As a general rule rates should produce sufficient revenues to cover relevant costs, but cost is not the sole determinant of price. Appropriate consideration must also be given to other pertinent factors, especially as applied to a class of competitive service which is supplementary to the principal or monopoly services of the carrier. In order to assure the viability of the carrier and avoid the subsidization of one class of service by other classes, the Airlines state that rates should be "compensatory," i.e., the rates for a class of service should provide revenues sufficient at least to cover the "relevant" costs of furnishing that service, and that the "relevant" costs in determining whether rates are compensatory are "long-run incremental costs," defined as the increase in the total cost of investment and expenses, including a reasonable rate of return on capital, which would be incurred by the addition of a particular class of service, or of furnishing additional quantities of service in an existing service category, or, more stringently, "avoidable costs," the costs which would be saved, escaped, or not occasioned if the class of service were discontinued or not offered. (Airline Parties, Exh., No. 1, pp. 5-11.)

35. It is asserted that properly measured long-run incremental costs determine the rate floor or minimum rate level of a class of service. If the rates of a service cover their LRIC, they are compensatory and cause no burden on other services (Airlines P.F., pp. 83-88). However, the Airline parties contend that Bell's meaning and definition of burden is different in that the Bell burden test is oriented toward cross-elasticity. The Airlines maintain that failing the Bell burden test does not mean that the service must be eliminated as non-compensatory (Airlines P.F., pp. 79-88).

36. As to the specific TELPAK rates at issue herein, the Airlines contend that the original TELPAK rates were probably compensatory and that the "interim" rates effective September 1, 1968 were clearly compensatory. The Airlines maintain that the TELPAK rates effective February 1, 1970 and May 4, 1972 are unreasonably high, unjust and unreasonable. The amounts collected above the interim rates (which the Airline parties claim should be a rate ceiling justified on the basis of costs of competitive alternatives) effective September 1, 1968 should be refunded pursuant to the accounting orders under which those rate increases were originally suspended. (Airlines P.F., pp. 70-75, Airlines BSE, pp. 60-65.) Finally, the Airlines suggest that a new bulk rate communications offering would appear to be appropriate, based on competitive necessity and route density. (Airlines P.F., pp. 162-68.) Bell's monopoly users would be protected by holding monopoly rates to a "ceiling" reflecting the company's revenue requirement minus the costs directly attributable to the competitive services, on the basis of retrospective cost-causing responsibility. (Airlines BSE, pp. 46-53; Airlines P.F., pp. 151-58.)

Aeronautical Radio, Inc. (ARINC)

37. Arinc's position is generally the same as that of the Airlines. It contended that the bulk rates of the Telpak offering have stimulated the growth of the communications market, assisted the effective operation of the government, have promoted a major betterment in the conduct of major industrial and business enterprises, and have generally benefited the public at large through improved safety, services, and productivity. (Airlines, Exhs. 2-5, DOD, Exhs. 1-2, Ad Hoc Committee, Exh. 1.)

38. Arinc contends that except where strong public interest considerations dictate a lower rate level, the rates for each service offered by a common carrier should be "compensatory." A service is compensatory if it covers the LRIC (or in some cases, the "avoidable" cost) of offering the services (Arinc P.F., pp. 32-5). No method of FDC analysis based on historical costs can test for compensativeness. FDC requires a distribution of costs which cannot be allocated by any rational principle. (Arinc P.F., pp. 35-40.) Resort to an FDC method based on historic cost responsibility may be useful in setting maximum rates for monopoly services, but such analysis has no role in determining minimum rates. (Arinc P.F., p. 126, Airlines BSE, pp. 33-38.)

39. Arinc argues that a rate may somewhat exceed the minimum level of compensativeness and remain reasonable. Rates in total should be high enough for the carrier to make a reasonable return on investment. Competitive service ratemaking must consider market condi-

tions. Such rates must be low enough so that the carrier will be able to retain the business which would otherwise be lost. (Arinc P.F., pp. 126-127.)

40. Arinc contends that the cost of comparable service from a private microwave system serves as an independent standard of the maximum rate level for the carriers. Further, TELPAK service has been shown to be compensatory at the original rate level. The "interim" TELPAK rates of September 1968, although less competitive than the original rates, are reasonably related to the cost of private microwave. Arinc asks that the rates of February 1970 and May 1972 be cancelled because they were substantially above the cost of competitive alternatives and thus unjustly and unreasonably high. TELPAK rates should be returned to their original level and the telegraph to voice equivalency should be returned to 12:1 (Arinc P.F., pp. 115-17). Arinc requests that increased charges for teletypewriter station equipment, private line terminals, installation charges and CCSA service have not been supported by Bell and should be rescinded. (Arinc Expt., pp. 87-103.)

The Department of Defense and U.S. Executive Agencies (DOD)

41. In behalf of the U.S. government executive agencies, DOD takes the position that the availability of a bulk rate offering, such as TELPAK, is required and justified by competitive necessity. Such an offering is essential to the efficient accomplishment of the tasks of the Federal executive agencies and its elimination would lead to a degradation of national defense capability. Lower TELPAK rates are justified and the elimination of TELPAK would force the government to consider private microwave since government policy requires procurement at the lowest cost (DOD P.F., pp. 8-10). DOD has maintained that long-run *average* cost (LRAC) techniques (versus LRIC) must be employed to assure that a rate is compensatory. DOD noted that for a particular interval of service and period of time, if all resource costs are included, LRIC equals LRAC. (DOD P.F., pp. 24-27.) Where such long-run average cost analyses cannot be supplied, a burden test, as an "equality" rather than an "inequality," must be used for a finding of compensativeness (DOD P.F., pp. 28-29, 79-80). It is further maintained that FDC cannot be used as a test for interservice subsidy and that FDC Method 1, in particular, is invalid, inaccurate and inapplicable as a cost mechanism, and its use would result in an anticompetitive umbrella. (DOD P.F., pp. 30-34.) DOD notes that if the Commission feels bound to employ fully distributed costs, it should use Method 7 because it reflects economic reality to the maximum extent possible. DOD also finds Bell's market studies inaccurate and unreliable. (DOD Expt. No. 1; DOD P.F., p. 32.)

Ad Hoc Telecommunications Committee (Ad Hoc)

42. This party, in behalf of a number of large industrial users of private line services, concurs generally in the position of the Airline parties and contends that a differential between the TELPAK and non-TELPAK rates for regular private line telephone and telegraph services is justified by the volume needs of larger users and the car-

riers' need to compete with private microwave systems. (Ad Hoc BSE, pp. 7-16.) It is stated that TELPAK is compensatory and should be continued in essentially its present form. (Ad Hoc P.F., p. 45; BSE, p. 5.)

National Association of Motor Bus Owners (NAMBO)

43. NAMBO concurs in and adopts the position of the Airline parties and urges the Commission to roll back the TELPAK rates "at least to the levels proposed by the Airlines" and to order refunds to the users who paid in excess of such levels. (NAMBO P.F., p. 6; Expt., pp. 2-3.)

Microwave Communications, Inc. (MCI)

44. MCI argues that FDC Method 1 must be the principal working tool of the Commission for the determination of rate levels for Bell System services. This is a proper allocation method and the only methodology in the record which attempts to measure the costs of providing service on the basis of current actual usage of facilities. Bell's rates, according to MCI, must provide revenues to cover all costs of the service including the system-wide rate of return on net investment if such rates are to be compensatory and non-discriminatory. MCI asserts that in a competitive market the most efficient carriers will be identified and will succeed, if fully allocated costs are required and the distortions of subsidy are eliminated.

45. MCI contends that Bell's approach is not reliable or effective and should not supplant the Commission's traditional analytical tool of fully allocated or fully distributed costs. Bell's burden test cannot measure cross-subsidy from MTS and WATS to competitive services. It is further asserted that Bell's LRIC is substantially different from that found in economic theory and that the development of proper LRIC techniques and the training of regulatory personnel to handle filings based on LRIC analysis would be difficult and costly.

46. MCI contends that Bell's and Western Union's rates for TELPAK C and D, private line telephone, and private line telegraph should be raised forthwith to the levels indicated by the best presently available fully distributed costs studies and the rates for the monopoly services should be reduced correspondingly (MCI P.F., pp. 104-108; MCI BSE, pp. 3-5, 6-7).

Data Transmission Co. (Datran)

47. Datran contends that Bell's application of long-run incremental costs (LRIC), if adopted by the Commission, would create a positive inducement to Bell to practice interservice cross-subsidization (Datran P.F., pp. 15-16). Monopoly rates are based on historical costs and competitive prices are based on forecasts. LRIC is inimical to full and fair competition since no other carrier has a monopoly service which under the LRIC theory remains as a catch-all and guarantor of support for Bell's competitive services (Datran P.F., p. 16).

48. Datran finds Bell's application of LRIC deficient. Datran views LRIC as a planning concept for the selection of the best course of action before decisions are made and reflects only the differences in cost between two specific alternatives. Datran claims that there may be an infinite number of LRIC's depending on the judgments of the decision maker. The burden test is inappropriate as a measure of cross-

subsidy because it assumes perfect knowledge of future alternatives. Thus the burden theory only measures Bell's expectations of whether a service is expected to be a burden under specifically defined circumstances. (Datran P.F., pp. 16-18.)

49. Datran argues for the adoption of a fully distributed cost standard. The FDC standard would allow Bell at least as much pricing flexibility as any other carrier and spread advantages of economies of scale (if any) to all services. FDC is consistent with the criteria used in determining Bell's interstate revenue requirement and its use would add realistic cost benchmarks to the Commission's regulatory information base. Datran notes that FDC should be adopted as the rate ceiling for Bell's monopoly services. (Datran P.F., pp. 18-19.)

The Western Union Telegraph Co. (Western Union or WU)

50. Western Union asks us to reject LRIC and other ratemaking principles advocated by Bell and accept fully distributed costs as the most reliable and practical basis for pricing Bell's services (WU P.F., pp. 55-58). It is contended that Bell should be allowed to make no more than a fair rate of return on MTS and WATS. Further, Bell's competitive services should be priced no lower than the fair rate of return on investment reasonably allocated to such services. Upon a showing of competitive necessity, Bell may price these services lower. However, such rates must permit Bell to recover its fully allocated revenue requirements for such services within a reasonably foreseeable future period. (WU P.F., pp. 57-8.)

51. Western Union claims that the TELPAK service should be cancelled because it is non-compensatory and therefore unjust and unreasonable under Section 201(a) of the Act. Also, minimum rates should be prescribed for Bell's private line telephone and private line telegraph classifications which result in earnings (on a fully allocated basis) at the lower end of the allowed interstate return range. Bell should also lower its MTS and WATS rates so that they are earning in the middle of the allowed range. (WU P.F., pp. 96-98.)

The Network Parties (ABC/CBS/NBC) (Networks)

52. The networks contend that FDC is inappropriate for ratemaking purposes. FDC, they claim, ignores economic circumstances which should be considered in determining rates for services to be provided in the future (Networks P.F., pp. 44-60). LRIC, on the other hand, meets all of the criticisms levied against FDC and attributed costs on an economically justifiable cost-causing responsibility basis. The forward looking LRIC analysis leads to an optimal allocation of resources while accounting for relevant future costs and demand elasticities as well as other applicable ratemaking and public interest considerations. LRIC is consistent with judicial and administrative precedent. (Networks P.F., pp. 78-83.)

53. The Networks contend, however, that Bell's application of LRIC has erroneously led to the attribution of unduly high costs to the program transmission services. (Networks P.F., pp. 194-219.) When excessive and unneeded plant is eliminated from the cost base attributed to the video services, the record shows that such services do not cause any burden to other Bell services. The Networks claim that even without such adjustments, private line video services are shown by

AT&T's own data to provide a substantial annual contribution to the overall costs of the firm.

54. The Networks find that current rates discriminate unlawfully against contract service users in favor of occasional service users. They request generally lower rates for the future and appropriate refund of excessive contract charges paid to AT&T since October 2, 1969. (Networks P.F., pp. 220-30.) The Networks also point out that they already make extensive use of competitive alternatives and that further increases in Bell's rates will cause them to transfer even more of their business away from AT&T. (Networks Expt., p. 5.)

Hughes Sports Network, Inc. (HSNI)

55. HSNI opposes Bell's proposed rates for private line video program transmission services as violative of the Commission's rate structure decision in *Hughes Sports Network* v. *AT&T*, 22 FCC 2d 550 (1970). It is argued that there is insufficient evidence of any real threat of competition to Bell. LRIC offers unique opportunities for Bell to impose its "bias" and "anticipatory view of competition" into its ratemaking approach. (HSNI P.F., p. 89.) Sound policy requires responses by a carrier to only actual and demonstrated competitive consequences. AT&T, however, has been pressured to lower contract rates by the networks who have threatened to move their business to competitive alternatives. There is no record support for a competitive response by AT&T. (HSNI P.F., pp. 57-72.) Further, the Commission should not allow AT&T to revise its tariff structure to the benefit of contractual users (and the detriment of occasional users) without any pretense of showing or justifying proper allocation of costs between the two groups of users. (HSNI P.F., pp. 50-52.)

United Press International (UPI)

56. UPI contends that the increased charges involved in the private line service rate revisions filed by Bell on December 6, 1971 are unjust and unreasonable; that these rate revisions were filed at a time when no determination had been made by the Commission in either this Docket or Docket 19129 of the need by AT&T for any increased revenues, and indeed without significant regard for any impact upon overall earnings level considerations; and that the objective asserted by Bell was, in part, to improve the contribution to earnings of the private line services for the benefit of the users of other services, such as MTS, by raising the level of rates to what Bell considers the "optimum" level under presently foreseeable market conditions—this in spite of the fact that the private line telephone services were already making a substantial contribution to earnings and were thereby benefiting the users of other services, including MTS. (UPI P.F., p. 14.)

57. Further, UPI states that Bell made "selected" increases that were confined to the channel terminal components without any offsetting decreases in line haul charges and without any separate cost studies; that, therefore, a disproportionately large portion of the increases fell upon those customers, particularly the press wire services, whose communications systems involve multipoint network configurations with large numbers of service points, as distinguished from customers with point-to-point service and relatively few service points; and that

the press was treated in an unfair and discriminatory manner, particularly by increases in the telephotograph services (Series 4000). UPI urges the Commission to conclude that the rates of December 6, 1971 are unlawful because they discriminate against press customers. (UPI P.F., pp. 15-17.)

Associated Press (AP)

58. AP contends that AT&T has largely ignored services other than TELPAK and has not justified the increases imposed on short haul circuits or the increases in the monthly and installation charges for single channel private line service terminals. Further, the increased monthly charges for service terminals result in relatively higher charges to AP, and the press generally, which have not been shown to correspond to the cost of serving the press (AP P.F., pp. 7-11). Consequently, AP argues that these increased charges constitute an unjust and unreasonable discrimination against the press and subject it to an undue and unreasonable prejudice or disadvantage. (AP P.F., pp. 3-4.) Moreover, AP states that if AT&T is capable in the future of convincingly demonstrating that short-haul charges must be increased, it would seem that the appropriate approach would be increases for those line haul mileage bands where AT&T can show that revenues do not cover long-run incremental costs. (AP P.F., p. 15.)

Aerospace Industries Association (AIA)

59. AIA states that TELPAK is competitively justified, in fact some of its members have already turned to competitive alternatives (T. 15753). It is further urged that the Commission evaluate the contributions made by AT&T's private line services using the principles of long-run incremental costs (AIA P.F., p. 59) and that no rate prescription be made until a new cost study is performed by AT&T.

V. STATUTORY STANDARDS

60. We agree with the RD that Sections 201, 202, 205, and 214 of the Communications Act provide the relevant statutory standards for resolution of the issues herein. Principally, we are guided by Section 201 which requires that charges, practices, classifications and regulations shall be just and reasonable. And, in determining to what extent costs should be allocated among Bell's service categories consideration is to be given Bell's obligation under the above sections to provide, upon reasonable request, service without regard to whether the service is characterized as monopoly or competitive. Furthermore, our decision herein maintains that a carrier has a duty to continue to provide an already existing service, unless the Commission permits discontinuance pursuant to Section 214 of the Act. As the RD recognized, appropriate rate levels for Bell's service categories must also comply with the standards of Section 202(a) of the Act. This section prohibits a common carrier from making any unjust or unreasonable discrimination in changes, practices, classifications, regulations, facilities, or service in connection with like communications services. Additionally, service is to be provided without any undue or unreasonable preference, advantage or disadvantage. These standards are discussed in greater detail below. It is also recognized that several statutory provisions (Sections 201(b), 210(b), and 396(h)) expressly permit dif-

ferential pricing by carriers for certain classes of communications under specified conditions.

61. The Airline parties, ARINC, and DOD have noted as an exception the RD's failure to specifically include Section 1 of the Communications Act as a relevant standard in resolving the issues in this proceeding. While our reading of the RD leads us to conclude that this section containing the Act's basic mandate was implicit as a standard, we here explicitly acknowledge our obligation to ". . . make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges, for the purpose of the national defense. . . ."

VI. LEGAL PRECEDENT

62. Several parties criticize the RD's reliance on *Northern Pacific Ry.* v. *North Dakota*, 236 U.S. 585 (1915) and other decisions as support for the position that fully allocated costs are the appropriate standard in determining rates for individual service categories. These parties claim that *Northern Pacific Ry.* is inapposite since it pertains to a *state's* unlawful attempt to set maximum rates no greater than incremental costs in contrast to the instant proceeding, where a *carrier's* attempt to establish incremental costs as a pricing floor is at issue. These parties cite and rely upon another line of cases from which they argue that there exists regulatory and judicial approval for incremental costs as the appropriate ratemaking standard. It is correct that courts have found rates compensatory, when they are set above incremental costs.[41] However, our reading of these cases fails to reflect any manifestation of judicial preference for an incremental costing approach, as opposed to a fully allocated approach.

63. We do, however, take judicial guidance from *American Commercial Lines* v. *Louisville and Nashville R. Co.*, 392 U.S. 571 (1968). This case concerned the question of whether incremental costing or a fully allocated costing methodology was the appropriate standard in determining inherent cost advantages between modes of transportation. *American Commercial Lines* stands for the proposition that in the absence of clear Congressional directives, it is within the sound discretion of a regulatory agency to establish appropriate economic policy to effectuate its legislative mandate.[42] We note that the Communications Act contains no express direction regarding the choice of a particular costing methodology. Consequently, in view of *American Commercial Lines*, we need not distinguish among the holdings of the cases relied on in the RD and by the various parties, nor need we consider any particular costing methodology to be judicially sanctioned. Our conclusions will, therefore, be based on the record, the mandate to ensure just, reasonable and non-discriminatory rates.

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[41] *See, e.g., ICC* v. *New York, N.H. & H.R. Co.*, 372 U.S. 744 (1963).

[42] We are thus not bound by the Supreme Court's decision upholding the ICC's determination that under Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. § 15a(3) (1970), fully distributed costs should be used respecting the particular intermodel rate controversy, pending a subsequent rulemaking. We do note, however, the Court's lengthy footnote, 392 U.S. at 586-89, n. 16, wherein it raised serious questions concerning the economic rationale of a costing methodology that is conceptually similar to LRIC. However, the Court concluded that the resolution of such questions is within the discretion and expertise of the regulatory tribunal.

64. It is argued by a number of the parties that the RD's conclusion that FDC Method 1 is the appropriate costing approach is unwarranted and that any method that attempts to allocate common costs is inherently arbitrary inasmuch as there are any number of ways to allocate costs. We agree that there is no one perfect method by which to allocate costs of services.[43] But, this does not mean that we are precluded from choosing a reliable costing method that best reflects our policy objectives emanating from the Act.[44] (See Section VIII *infra.*) Thus it is within the exercise of our informed judgment to choose the methodology we find proper under the attending circumstances.[45] Many years ago the Supreme Court recognized that ". . . it is much easier to reject [costing formulas] as being misleading than to find one apparently adequate."[46] Yet, it is our responsibility to make such a choice by this decision.

65. For these reasons we conclude that we are not constrained, merely because other methods are also plausible, in the selection of the methodology we employ herein for determining appropriate rate levels and the presence of cross-subsidy among individual categories of interstate telephone service.

VII. PRIOR POLICY

66. The RD found prior Commission policy supports the following conclusions related to resolution of this case (RD, par. 95);

(1) ascertainment of the actual cost of providing services underlies the requirement that rates be just, reasonable and nondiscriminatory;
(2) the public interest is not generally served by interservice cross-subsidization; and
(3) the Commission has previously dealt with the question of cross-subsidization, but in the context of fully distributed costs.[47]

Bell, the Airline parties, ARINC, AIA, and DOD have excepted to the appropriateness of one or more of these basic conclusions as reflecting prior Commission policy.

67. The importance of costs has long been recognized in our determination of the lawfulness of rates of telecommunications services.[48] It thus follows that our determination of the lawfulness of the rate levels of the major interstate service categories at issue herein, must be justified in relation to the cost of furnishing the particular service. This does not mean, however, that cost is necessarily the only criterion useful in determining whether rates are lawful under the Act. Prior cases have made it clear that besides using costs as the basis for setting rates, costs can be used as benchmarks to guide us in measur-

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[43] *See, e.g., Colorado Interstate Co.* v. *FPC*, 324 U.S. 581 (1945).
[44] *E.g., Consolidated Gas Supply Corp.* v. *FPC*, 520 F.2d 1176 (D.C. Cir. 1975).
[45] *See, e.g., Panhandle Eastern Pipeline Co.* v. *FPC*, 324 U.S. 635 (1945).
[46] *Groesback* v. *Duluth, S.S. & A. Ry. Co.*, 250 U.S. 607, 614-615 (1919).
[47] The RD's conclusions concerning our prior policy with respect to differential pricing under Section 202(a) is discussed below at Section XII.
[48] *E.g.*, Private Line Rate Cases, 34 FCC 217, 231 (1963); 34 FCC 244, 297 (1961); "Hi-Lo" 55 FCC 2d 224 (1975), 58 FCC 2d 362, 366 (1976); WATS, 59 FCC 2d 671, 678 (1976).

ing the extent and lawfulness of any departure from actual costs, where non-cost considerations enter the ratemaking calculus.[49] Of course, departures from rates based directly on costs must be justified.[50]

68. There have been a limited number of circumstances where rates have been allowed to depart from costs. We previously held, with respect to like communications services, that competitive necessity might justify differential pricing, even though the differential is not cost related provided certain conditions are met.[51] Likewise, the RD recognized that departure from costs in setting rates for press communications services might be warranted (RD, par. 93). However, to date no showing has been made before the Commission that would justify any non-cost differential pricing for press services.[52] It is also clear that where Congress has made special provision, rates for particular service categories may depart from costs. Thus, under Section 396(h) of the Act, we have allowed Bell to provide private line service to educational television stations at reduced rates, even though the costs of such service were not fully recovered in the tariffed charges.[53] However, the extent to which non-cost considerations such as market demand and competitive factors should be taken into account in permitting departure from costs has not yet been settled.[54] This is one of the questions to be addressed herein. (In answer we set forth the guidelines to determine cost of service, as well as the basis for justifying departure therefrom. We make clear, however, as did the RD, that we will continue to entertain other appropriate bases of departure from the cost standards sanctioned herein, upon appropriate justification.)

69. We are in further agreement with the RD that our prior decisions reflect that cross-subsidization is generally not in the public interest. In the *Private Line Rate Cases* we stated:

> Care must be taken to avoid excessively high rates for a carriers' noncompetitive services (or for a noncompetitive classification) which tend to offset deficiencies resulting from unduly low rates for competitive services. 38 FCC at 301.

Similarly, in *Re WADS*[55] we expressed concern that there might be cross-subsidization between different classes of WADS service. More recently, we ruled that Bell had to demonstrate that there was no cross-subsidization among the distinct service elements of its "Hi-Lo" offering as well as between the Hi-Lo service and other services offered by the company.[56]

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[49] 34 FCC at 231; 34 FCC at 297; WATS, 59 FCC 2d at 678.

[50] Private Line Rate Cases, 34 FCC at 231; 34 FCC at 297; WATS, 59 FCC 2d at 678.

[51] Telpak Rates, 38 FCC 370 (1964).

[52] Charges and Classifications for Services Furnished to the Press, 24 FCC 2d 565 (1970), 25 FCC 2d 5 (1969), *aff'd sub. nom., Copley Press* v. *FCC*, 425 F.2d 1290 (1971). We note that we are investigating the issue of preferential press rates in Docket No. 20667. That proceeding, however, is being held in abeyance pending resolution of the issues herein and in Docket No. 20814, an investigation into AT&T's Multi-Schedule Private Line (MPL) rate filing. Preferential Rates for Press Use of Domestic Private Line Service, 56 FCC 2d 796 (1975); FCC 76-718 (Released, August 13, 1976).

[53] Free or Reduced Rates, 17 FCC 2d 155 (1969); 20 FCC 2d 491 (1969); 31 FCC 2d 496 (1971).

[54] We recognize that in the *Private Line Rate Cases* consideration was given to non-cost criteria including value of service and competitive effects in prescribing the appropriate rate levels for individual services. 34 FCC at 227; 34 FCC at 298. It is nevertheless clear that the cost of providing service was at the heart of that decision. 34 FCC at 228, 231; 34 FCC at 297, 300.

[55] 35 FCC 166, 183 (1963).

[56] 55 FCC 2d 224, 230 (1975); 58 FCC 2d 362, 368 (1976). The "Hi-Lo" filing was rejected, in part, because of Bell's failure to make an adequate showing that cross-subsidization did not exist among the services.

70. From the foregoing it is manifest that costs have played a predominant role in determining whether rates are just and reasonable under our statutory standards. But, in certain circumstances, other non-cost criteria can be employed in the ratemaking process, provided we have full awareness of what the costs of services are, and the extent of departure therefrom. Furthermore, we have established that cross-subsidization between services is generally inimical to the public interest, but acknowledge that definitiveness and certainty are presently lacking in any definition of cross-subsidy.

71. We feel that these broad principles, which have served as the foundation of our ratemaking decisions for the past fifteen years, continue to be viable for purposes of resolution of the instant proceedings. Nevertheless, in view of the position taken by Bell and others we emphasize that we have not "prejudged" certain issues herein based on past holdings. We have examined *de novo* the issues and questions presented herein on the record. Thus, it still must be determined in this proceeding whether some form of fully distributed costs, marginal or long-run incremental costs or, indeed, some other variety or combination of costs should serve as the relevant costing standard. Furthermore, in determining the lawfulness of the rate levels at issue herein we must decide whether circumstances exist justifying a departure from a cost standard. Finally, we must define what constitutes cross-subsidization and whether cross-subsidization exists between the service categories under examination. Numerous orders in this proceeding,[57] as well as in proceedings dealing with related questions[58] make it clear that we have not resolved nor predetermined the issues posed herein.

VIII. STATUTORY OBJECTIVES AND RESPONSIBILITIES

72. Underlying resolution of the basic issues in this proceeding (the determination of the lawfulness of rate levels and rate level relationships of Bell's principal categories of service) are the objectives and responsibilities which evolve from our enabling statute and prior decisions. In the discussion above on prior Commission policy (Section VII), it was shown that our prior decisions held cross-subsidization generally undesirable. Furthermore, the recognition of costs as providing primary underlying support for determining the lawfulness of rates and rate structures has been established, but the determination of what constitutes "relevant" cost remains.

73. We emphasize that ascertaining relevant costs is essential to our primary ratemaking responsibilities under the Act—the determination of whether rates are just, reasonable and not unduly discriminatory. Likewise, knowledge of the cost of service permits identification of interservice burdens and cross-subsidization. An understanding of relevant costs is directly related to carrier accountability for the rates, charges, rules and practices contained in its published tariffs.

74. Pursuant to Sections 219 and 220 of the Communications Act of 1934, as amended, we are empowered to prescribe uniform accounting systems and depreciation charges, and to require submission of such

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[57] 18 FCC 2d 761, 763; 23 FCC 2d 503, 508-509; 41 FCC 2d 593-594.

[58] Specialized Common Carriers, 29 FCC 2d 871, 916-917 (1971), "Hi-Lo," 58 FCC 2d 362, 364 (1976).

records, reports, and studies as we deem necessary to carry out our legislative mandate. Likewise, the Commission may, under Section 218, inquire into the management of common carriers and keep itself informed as to the manner and method of management. Consequently, the Commission may make periodic inquiry of the carriers it regulates and establish appropriate reporting rules to facilitate determination of the justness and reasonableness of carrier rates, practices, classifications, and regulations. This is illustrated by the requirements of Sections 1.363 and 61.38 of the Commission's Rules and Regulations. Thus, our statutory mandate and our rules manifest our paramount responsibility to the public to ensure carrier accountability for the rates, charges, practices and rules published by the carriers.

75. Until the early 1960's, the Commission relied primarily on informal procedures termed "continuing surveillance" as the principal vehicle for carrying out its statutory responsibilities. This approach could best be characterized by the Commission regulating rates through "frank" and informal negotiations in lieu of rate investigation, hearing and prescription.

76. With the advent of declining costs resulting from recurring technological breakthroughs in transmission and switching, escalating demand, authorization of private microwave systems, and competition in the intercity private line market by terrestrial and satellite carriers, the need arose for more structured and formal rate regulation. Likewise, there also arose the commensurate need for reporting rules. Indeed, the sections of the Commission's Rules cited above were developed in the period after the emphasis on carrier accountability had shifted from informal to more structured and formal procedures.[59] The current proceeding evolved in this era and the Commission's objective of ensuring carrier accountability became intertwined in the controversy surrounding the related issues of proper ratemaking principles and procedures.

77. Ensuring carrier accountability is one of our primary objectives and responsibilities. All parties appear to agree that an established carrier should be held accountable for its pricing and investment decisions. There is also agreement that the modern complex structure of the industry characterized by the importance of technology and controversy over appropriate capital structures requires that a formal approach to carrier accountability be taken. However, the parties do differ regarding proper pricing and costing methodologies as the same reflect on accountability. The parties also disagree as to proper forecasting and tracking procedures, and the appropriate data to be used for such purposes. Additionally, the parties do not concur regarding the role forecast data should play in setting rates, or how uniform the employment of forecasting and tracking procedures should be between services. Furthermore, they are ambiguous in their description of how acknowledged substandard performance should be handled, including the important matter of shortfalls in net revenues resulting from deviations between actual and projected results. Finally, the parties do not clarify whether the Commission should employ yearly or more frequent audits, single or recurrent evaluative references to base year forecasts, or adjusted (rolled forward) or fixed baseline projections.

[59] *See e.g.*, Final Report and Order in Docket 18703, 25 FCC 2d 957 (1970).

78. The RD proposes ratemaking on the basis of historical FDC Method 1 costs and also the submission of forecasts on a basis consistent with Method 1. This dual use of Method 1 effectively circumvents incompatibility between forecasting and tracking procedures, and, assuming the acceptance of the Method 1 approach, makes detection of cross-subsidization somewhat perfunctory (see RD, par. 179). Comparisons of forecast and test year evidence would be submitted including forecast rates of return (except on wholly new services for which no test year data would be required) (RD, pars. 212-215). The RD acknowledged that retrospective comparisons of forecast and actual data have the inherent limitation of considering performance only opposite the alternative chosen (RD, Appendix B, pars. 20-39; CCB Exhs, 7 and 25). The RD also favors closer examination of the carrier's justification for not choosing other rate alternatives as part of the overall accountability process.

79. The RD's references to accountability are oriented toward the determination of full cost rate levels to cover historical revenue requirements. It is noted that "FDC study results by service are useful for tracking the results of rate changes and all other influences that affect the revenue-cost relationship of major service categories" (RD, Appendix C, par. 85). The RD is concerned that any comparisons that would be made of forecasts with the results of operations should be as firmly founded in actual data as possible. It is partly for this reason that the RD held objectionable the suggestions of other parties that use be made of Methods 3 to 7 for tracking purposes. The RD relied on Method 1 rather than Method 7, for example, since it concluded that results under Method 7 are partly composed of data drawn from forecasts of the "near and distant future" (RD, Appendix C, par. 87).

80. The RD does not address several of the ambiguities regarding "accountability" referred to earlier. While its use of Method 1 provides for consistency between forecast and actual results, projected data need not have any actual part in setting rates. Indeed, the RD's conclusions suggest that forecast results would only be informational. Furthermore, there are no provisions made for incorporating "rewards or penalties" into the RD's scheme of ratemaking to recognize disparities that might be found between actual and projected results. Shortfalls would presumably be covered by rate adjustments. Finally, the RD does not clearly delineate what it would consider to be proper procedures for a tracking or continuous surveillance program, as opposed to the more general projections currently required under Section 61.38 of the Rules.

81. The RD's recommendations on the use of forecast data and procedures are tied to its concern with cross-subsidization—especially as it might be accomplished through the vehicle of managerial judgment in cost allocation. The RD generally found that reliance upon such judgment in the ratemaking process is not in the public interest. To this end, only minimal importance is attached to such data for purposes of the ratemaking process.

82. The Bell System's most prominent reference to "accountability" was in connection with its "retrospective accountability" analysis. Bell maintained that there is no evidence of record supporting the validity or feasibility of projecting Method 1 data. Bell argued that such projections and any deviations in actual results from these projections have

no import for ratemaking purpose (Bell Expt., pp. 3-5, and 120-121). Bell has also maintained that any proper test of cross-subsidization *must* be of an incremental, forward-looking nature such as the Burden Test proposed by its witness, Dr. Baumol (Bell Exh. 18, pp. 6-7). It was in addressing the objections of Common Carrier Bureau witness, Dr. William Melody, to such a test that Bell directed its attention to the issue of restrospective accountability (CCB Exh. 7, pp. 5-27). Bell acknowledges the Commission's need for historical cost based analyses to serve as "benchmarks" in evaluating interstate service rates (Bell BSE, pp. 47-54).

83. Dr. Melody testified (CCB Exh. 7, pp. 19-22, 32-35) that under Bell's incremental analysis the Commission would have no way of assuring itself that projected data was not biased. He also objected to the analysis in that it offered no information on actual performance. While not directly addressing the question of bias in an accountability context, Bell maintained that any forecasts, including full cost projections, are susceptible to the bias criticism. Bell asserted that proper documentation and record keeping by the carrier can minimize the "nonobjective" aspects of forecasting (Bell Exh. 18, pp. 13-20). With regard to the needs of the Commission for results of actual performance, Bell concurs with Dr. Melody that a comparison of actual and projected results is appropriate in ensuring carrier accountability (Bell Exh. 20, pp. 13-19). It alleged, however, that only the directly attributable costs of a service should be compared with forecasted changes in revenue/cost relationships as estimated by incremental studies (Bell P.F., pp. 108-119).

84. We find that accountability for the Commission's purposes should involve comparative evaluations of forecast and actual costs, and should incorporate the findings of such analyses into the ratemaking process. This is in accord with our prior policy, as formulated in the *Private Line* and *WATS* cases wherein we stated that costs can be used as benchmarks in the ratemaking process.[60] While the parties' interpretations of accountability seem to approve use of more than simply the informational aspects of forecasting, there is no delineation of the specific means of implementing the results of the evaluative process. We deem the latter to be requisite. Additionally, we find that accountability should also involve consistency in forecast and actual methodology and in the dimensions of the data employed. Finally, we find that accountability should be implemented across all services and for anticipatory (continuous surveillance) as well as retrospective purposes. Thus, accountability is the touchstone of the "just and reasonable" provision of Section 201.

85. Other statutory objectives and responsibilities include ensuring equitable and non-discriminatory treatment of all service users, (generally referred to herein as "equity"), promoting efficiency and technological innovation, and providing a precise and clear set of market rules for planning and decision making purposes. As indicated, these objectives collectively have a direct bearing on the major issues of lawfulness of return levels and relationships and also on the selection of proper costing methodologies and procedures for the future.

86. Equity can be viewed in a general framework, as follows: Users

[60] 34 FCC 217, 231 (1963); 59 FCC 2d 671, 678 (1976).

of the carrier's various offerings are entitled to non-discriminatory treatment with regard to the quality and diversity of service made available to them. This is true with respect to the carrier's definition, selection and allocation of costs, the type of facilities dedicated to various services, and the "relative weight" assigned by management to the myriad of other objective and implicit factors used in determining particular service rates. Furthermore, equity extends to such decisional areas as research and development and to facility construction program designs. These decisions must be commensurate or reconciled with the relative levels of earned return and benefits afforded users of Bell's various services.

87. The presence of competition in certain market segments raises certain equity questions concerning compatibility of pricing philosophies designed to "meet competition" vis-a-vis those used to price monopoly services. The concept of equity is embodied in Section 202(a) of the Act. This section specifies that it is unlawful for any carrier "to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality. . . ." Further, Section 201(b) of the Act specifies that "all charges, practices, classifications and regulations for and in connection with such communication services, shall be just and reasonable. . . ." The Bell parties, as we have discussed, espouse a "basic service" philosophy of ratemaking, i.e., Bell alleges that it is reasonable to price competitive services on a "contributional" or marginal basis while simultaneously requiring monopoly service rates to cover all other costs; thus acting as guarantor that the overall revenue requirement is met (T. 15592-15609). Whether such a basic service theory of ratemaking is equitable and, indeed, lawful under Sections 202(a) and 201(b) of the Act is at issue herein.

88. The RD concludes "that it is unjust and unreasonable to require users of any class of service . . . to contribute earnings on such services in excess of what the Commission has found, after hearing, to be reasonably necessary to meet the overall revenue requirements of the carrier" (RD, par. 183). Additionally, the RD maintains that our prior decisions reject the view that pricing monopoly services at higher levels than competitive services to prevent shifts between them is justified (RD, par. 87). Further, the RD states that we have found that the "bare fact that a service may be enjoying a more rapid rate of growth does not itself justify imposing artificial rate burdens on it" (*Private Line Cases*, 34 FCC 217, 228; RD, par. 86). However, the RD does acknowledge that we have stated "our intention to permit the existing carriers to price their competitive services in a fashion that will realistically and reasonably reflect economic advantages, if any, that are inherent in the plant and operations of those carriers" (*Specialized Common Carrier Decision*, 29 FCC 2d at 915; RD, par. 208).

89. On balance, what we have at issue with respect to equity among users when viewed in the perspective of Sections 201(b) and 202(a) of the Act and our prior decisions is the lawfulness of the *results* of Bell's disparate pricing philosophy on the residual (monopoly) service ratepayer. As discussed in more detail below, it is not clear that Bell's ostensible efficiency-related rationale for its pricing approach coincides with the ratemaking objectives of the Commission. However, assuming *arguendo*, that we could accept the basic service philosophy of pricing as the appropriate economic means of reflecting Bell's economic advan-

tages of scale and of being the "going concern" vis-a-vis its incipient competitors, could we properly hold lawful the corollary results of the basic service theory that may dictate higher rates for monopoly users? That is, should the Commission find Bell's economic arguments advanced for its pricing philosophy so persuasive that special treatment of competitive users as selected "marginal customers" overrides other precedental and statutory considerations?

90. The above discussion of underlying legal and economic factors was predicated on the assumption that the basic service philosophy was the proper pricing approach. As will be explained in reviewing the arguments respecting full and marginal costing, below, this assumption implies that monopoly users would have lower discounted revenue requirements for the time period including "the near and distant future" due to the special treatment afforded competitive customers. If, however, treating competitive and monopoly service users in a disparate fashion does not satisfy this assumption, the Bell position then stands to prejudice monopoly ratepayers.

91. Another objective of the Commission is to encourage efficiency and innovation in the provision of telecommunications services. Under the basic mandate contained in Section 1 of the Communications Act, we are to "make available, so far as possible, to all the people of the United States a rapid efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges. . . ." The RD related efficiency directly to production and costs and also to discrimination:

> Generally, rate regulation is intended to be a substitute for competition in special market situations where an essential service or good is produced and maximum efficiency (that is, minimum cost) can be achieved. . . . It is intended that rates be designed to cover the necessary costs at levels which allow no excess over the minimum cost of efficient operation and which reflect no undue discrimination. . . . (RD, par. 97).

92. The RD and other parties recognize the interdependence of efficiency and other Commission goals and criteria:

> For a multi-service concern it is necessary to develop techniques for detecting and correcting cross-subsidization. . . . Effective regulation requires appropriate measures by which to gauge the overall performance of the regulated enterprise and a system of incentives which will pull the operation in the direction of maximum efficiency. . . . In this regard, one of the principal regulatory needs is to establish an accountability standard which provides the regulator and management alike the means for evaluating the overall effect of a myriad of interdependent decisions . . . (RD, par. 100).

93. Likewise, ARINC relates specification of costing methodology, as part of the spectrum of "fair competition" rules, to efficiency. Of course, ARINC's particular methodological advocations are not in juxtaposition with those of the RD. However, both appear to concur that improper specification of costing and ratemaking rules would negate desired efficiency and innovational benefits of competition at their inception. ARINC quotes the concurring statement of Commissioner Washburn in the *Ho-Lo* case to the effect that improper costing signals "create strong incentives which will tend to distort the efficient use of existing plant. . . ." (ARINC BSE, pp. 31-32). The essence of ARINC's argument is that the dimensions of efficiency extend beyond isolation of the cost of factor inputs for a particular production function and operating constraints (both physicial and procedural).

94. Bell has contended in this and other proceedings that rates related to marginal costing rather than FDC methods should be used for pricing its competitive services to ensure efficient use of its facilities and to avoid protecting inefficient specialized carriers (see, 29 FCC 2d at 899). Thus, Bell states that "reliance on an FDC criterion interferes with pricing decisions designed to achieve more efficient utilization of facilities and to foster lower unit costs of providing services to all classes of communications users" (Bell P.F., p. 145). Bell contends that only costs causally allocable to each service alone are relevant for ratemaking purposes, although, as discussed heretofore, Bell argues that other non-cost ratemaking factors are relevant as well. Others find fault with this philosophy. The RD, for example maintains that overall, incremental cost based rates do not cover total costs, and that by definition, allocation and selective application of such costs in determining rates involves unreasonable and unlawful levels of management judgment, contrary to the interests of all service users. These issues are discussed at length in later sections (*see* Sections IX-XI).

95. We find our obligation to promote efficieny and innovation to encompass cost definition, minimization, and allocation. Furthermore, we recognize the interdependence of efficiency and costing. We do not limit our consideration of efficiency only to measurable transactions, but realize that the public interest may be served by recognizing factors not directly traceable to the marketplace. Thus our concept of efficiency incorporates such considerations as equity and social welfare. It is, therefore, broader than that espoused by economists or individual carriers. Accordingly, our selection of a proper costing methodology from this standpoint will be determined by defining the term "optimal" in a fashion quite apart from the "relevant ratemaking factors" used by Bell.

96. A final major objective of the Commission is clarification of market rules. In general, these concern market entry and exit, proper supporting material for tariffs, rate level floors and ceilings, interservice rate relationships, and the myriad of other marketplace specifications needed by suppliers for proper decision making and planning. The Commission's prior decisions encouraging competition in certain markets were made to attract those firms which will prove over time to be viable and effective alternative sources of supply. Such firms should be able to accurately gauge the attractiveness of communications markets with full knowledge of the rules pertaining to their own and the established carriers' opportunities, responsibilities, and limitations. For example, in other proceedings, we have endeavored to provide rules regarding interconnection and service and equipment definitions. In this proceeding our attention is directed to ratemaking principles. Our findings and conclusions herein are intended to provide the rules necessary to properly relate costs and both relative rates and rate levels. They should dissuade both incipient and established suppliers from participating in a particular service area because of the presumption that "protective umbrellas" will offset any patent inherent economic shortcomings.

97. In our *Specialized Common Carrier Services* decision, 29 FCC 2d 870, 915-916 (1971) we declared that we favored fair competition between established carriers and their then incipient competitors for

the intercity private line market. We noted the relevance of costs in this regard, but did not make a finding on what constituted a proper costing methodology, deferring that issue to this proceeding. We stressed (29 FCC 2d at 915-916) that it was, "our objective to promote and maintain an environment within which existing and any new carriers shall have an opportunity to compete fairly and fully in the sale of specialized services. Our ratemaking and regulatory policies and practices will be appropriately adapted to accomplish this objective. . . ." in Docket 18128.

98. The Commission has also expressed itself on fair competition in other proceedings. In the area of interconnection, for example, the Commission held unlawful attempts by established carriers to maintain unduly restrictive tariff provisions violative of fair competition:

> In *Specialized Common Carrier Services*, the Commission authorized new specialized private line carriers and issued a broad directive to the established carriers to make available to such new carriers local distribution facilities on a reasonable and non-discriminatory basis. 29 FCC 2d at 940. Although Bell provided local loop service to specialized common carriers, it would not interconnect its plant with [specialized carrier] facilities for the purpose of providing FX and CCSA services. In *Bell System Tariff Offering*, Bell argued that the interconnection policies enunciated in the *Specialized Common Carrier* decision did not require such interconnection. The Commission disagreed and, *inter alia*, ordered AT&T and the Bell System Companies to cease and desist from denying specialized carriers reasonable interconnection services similar to those provided to AT&T's Long Lines Department. . . . The Commission concluded that competition between Long Lines and the specialized carriers in the interstate private line services market would not be *full and fair* if the specialized carriers were prevented from providing FX and CCSA services by reason of monopoly control by Bell and other telephone companies over local plant. Similarly, we believe that competition between Long Lines and specialized carriers on routes served by both cannot be *full and fair* if subscribers of Tariff 260 services cannot terminate those services at IRC and specialized carrier premises. (emphasis added) (Memorandum Opinion and Order, FCC 76-684, July 30, 1976.)

99. There is general agreement in principle with the objective of fair competition (RD, pars. 208-210; Bell BSE, pp. 29-36) and that any costing methodology selected by the Commission for use in evaluating tariff filings and rate levels and relationships should be consistent with such objective. There is no agreement, however, in the interpretation and delineation of what constitutes "fair competition."

100. The RD relies on the *Private Line Rate Cases*, 34 FCC 244 (1961), 34 FCC 217, 231 (1963) in support of full cost pricing as the cornerstone of fair competition. The RD acknowledges that other pricing approaches may be warranted and, indeed, tendered for consideration by the Commission, but it notes that there must be special support in each such instance. Further, the RD holds that the burden of supporting specialized ratemaking always rests upon the applicant (RD, pars. 89-94). Within the context of full costing, the RD finds limitations on monopoly service earnings may be necessary to satisfy the requirements of Section 201(b) of the Act (RD, pars. 181-184). Without such limitations, the RD finds that cross-subsidization cannot be avoided, and that the Bell System would enjoy an unwarranted, anticompetitive "protective umbrella" (RD, pars. 208-210). Finally, within the context of fair competition the RD objects to any pricing approach that will not tend to provide maximum amelioration and coverage of revenue shortfalls that necessarily result from full cost pricing departures (RD, pars. 196-199).

101. The Bell System Respondents advocate that fair competition without cross-subsidization involves departures from full costing for certain services. However, full costs, appropriately defined, constitute part of Bell's overall approach. In this regard Bell advances its basic service philosophy as the ratemaking approach appropriate for the realization of fair competition (T. 15592-15600).

102. The apparent bases for Bell's pricing of services varies from service to service. For competitive (private line) service rates, Bell maintains that only long-run incremental costs are relevant. Bell suggests that its objective in employing a marginal cost based pricing approach is to minimize the share of total costs to be borne by monopoly (MTS and WATS) service users. Bell alludes to the theoretical efficiency of pricing in accordance with a service's marginal costs. However, Bell acknowledges that it uses a combination of cost, demand, and other factors in actually setting competitive service rates. (T. 15592-15604; Bell Expt., pp. 7-15, Bell P.F., pp. 26-39). Bell sets it monopoly service rates with the objective of meeting its aggregate revenue requirement (including cost of capital) for all its services. Since monopoly services are the "residual" or non-marginal offerings, Bell's objective of covering overall costs, in effect, makes these services responsible for covering costs not provided for by private line services.

103. Thus, the basic service philosophy of pricing provides an integral part of Bell's concept of full and fair competition. Under its view, prices related to incremental costs are to apply only to competitive services. However, Bell recognizes that investors presently view the firm as a whole, and that costs it regards for service category ratemaking as "economically irrevelant" (because of their historical nature), are in fact "financially important" and if not recovered are reflected in its aggregate cost of capital. For this reason Bell asserts that these costs *must* be covered by the residual services (MTS and WATS), if Bell is to earn its allowed rate of return. Rates for these two services, are, therefore, not viewed from a contributional standpoint as are competitive services. Basic service prices are set so that they cover the costs not contributed to by private line service revenues. (Bell P.F., pp. 26, 36).

104. Bell's conception of fair competition includes conclusions regarding "pricing flexibility" that can only be reached under its basic service philosophy. The RD generally does not support the contention that there is a need for flexibility in determining proper cost/price relationships among services, within the context of fair competition (RD, pars. 144-145, 157-159, and 185-187). However, whereas the RD held use of an FDC rate ceiling for MTS as necessary to avoid cross-subsidization, Bell finds this ceiling constitutes a limitation on its pricing flexibility and thus on the claimed contributional and efficiency related benefits all customers are alleged to derive from use of incremental cost related prices for other services (T. 15604-15606; Bell BSE, pp. 29-36). Bell maintains that such a ceiling for MTS defines a *floor* for other (especially competitive) services (Bell P.F., p. 51). This result naturally follows from Bell's stipulation that it must earn its overall revenue requirement. (Bell P.F., pp. 50-52). To summarize, Bell advocates that it be given the flexibility to reflect the latest technological advances and factor market prices in its private line rates, *only*

under the presumption that uncovered costs become the responsibility of its monopoly service users. We note that we believe reasonable pricing flexibility to be desirable, consistent with our findings and conclusions herein. However, as elaborated below, we cannot accept Bell's concept of pricing flexibility.

IX. THE COSTING METHODOLOGIES

A. Introduction

105. In Section VIII (Statutory Objectives and Responsibilities) we noted the existence of certain common ground among the enumerated objectives, and also areas of interaction between these objectives and the costing principles at issue beneath the penumbra of the Act. Further, given the foundation of our objectives, embracing concepts of *both* law and economics, employment of these objectives can produce alternative judgments or conclusions which, in varying degrees, need not be reinforcing. Judgments emphasizing the more legally oriented equity and accountability objectives, for example, may conflict with economic concepts of efficiency and fair market rules. Indeed, we noted that in given situations there may be conflicting legal and economic interpretations concerning proper employment of even a single objective.

106. In this section we outline and explore the concepts and underlying characteristics of fully distributed cost methodologies and marginal costing. We delve, as did the RD, into the origins and evolution of relevant complex socio-economic theory. Also for the necessary purpose of deciding this case as rationally as possible within the statutory, legal, economic and other technical and interdisciplinary constraints (such as accounting and engineering) which influence performance of our regulatory functions, we explore fundamental elements of the foregoing; indeed, sometimes esoteric elements and postulations. On such bases we explore the advantages and disadvantages of FDC and marginal costing in light of the objectives and responsibilities previously delineated. Thus, in the ensuing discussion we will, for example, examine the alleged efficiency shortcomings of FDC as well as the equity and accountability deficiencies ascribed to marginal costing.[61] Likewise, we will discuss the suitability of FDC for determining the lawfulness of rates and rate level relationships and of marginal costing in certain contexts.

107. The RD sets forth the role of costing methodologies in the regulatory process as follows:

> Generally, rate regulation is intended to be a substitute for competition in special market situations where an essential service or good is produced and maximum efficiency (that is, minimum cost) can be achieved by allowing one large-scale producer to supply a given market area. Restricting production to one producer in the market is for purposes of gaining the alleged benefits of economies of scale, i.e., the lower unit costs which are sometimes realized as the volume or scale of production increases. In the aggregate, the regulated enterprise is supposed to operate at "cost," where the term "cost" includes the cost of capital. It is intended that rates be designed to cover the necessary cost at levels which allow no excess over the minimum cost of efficient operation and which reflect no undue discrimination,

[61] Although it has been suggested on the record that economists can pursue their ends without the need to consider conflicting logic and data and without making value judgments (T. 10685-10695), the Commission is not so fortunate. We must decide this proceeding based upon a weighing of any number of factors, some of which may be at odds with each other.

either between classes of service or among different customers within a given service classification.

In some instances it may be both feasible and appropriate as a matter of public policy for a single producer to engage in both regulated monopoly and competitive markets. Here, a further objective of rate regulation is to prevent the presence of the integrated supplier from distorting the competitive marketplace, in order that the benefits of the full interplay of competitive market forces not be lost. This requires that the rates for competitive service offerings be set at appropriate compensatory levels, such that competitors are not subjected to unfair competition and the users of monopoly services are not required to subsidize the competitive service offerings of the integrated supplier.

In order to accomplish the various goals of regulation, certain tools and techniques are required. These include requirements for uniform systems of accounts and reports, audits, and related tests to ascertain the reasonableness of rate base elements and operating expenses including the costs of capital of the regulated enterprise. All of these elements taken together constitute a program of cost surveillance, since rates are to be designed to cover reasonable "costs." (RD, pars. 97-99).

In a firm which engages solely in competitive services, and where genuine competition exists for each service there is, of course, no public interest requirement to track the consequences of . . . management decisions; the free interaction of consumer choice and competitive response will automatically reward wise management decisions and penalize mistakes. Bell does not, however, fall in this category. The vast bulk of its service offerings enjoy monopoly or quasi-monopoly status, and are offered under uniform tariffs. The pricing of these services obviously cannot be and is not subject to the automatic corrections of the competitive marketplace. As Bell has eloquently argued in this and other proceedings, its monopoly and competitive services are provided via a single, integrated network involving extensive use of common facilities, personnel, management, and marketing resources. The allocation of proportionate use and value of these resources between monopoly and competitive services, and among classes of competitive services, constitute important management decisions not subject to the corrections of the competitive marketplace. Given the preponderance of its monopoly service demand, costs, and revenues, slight imperfections in these decisions will have little consequences for Bell's overall revenues and earnings; but for the same reason, even the slightest imperfection can have a major impact on the pricing of Bell's competitive services, with significant implications for both the users of those services and for Bell's competitors. In short, even small errors in management decisions in this area can result in significant underpricing or overpricing of Bell's competitive services, without a corresponding effect on its overall costs or revenues. This situation in turn can result in either predatory pricing or false entry signals for Bell's competitors. (RD, par. 101).

B. Full Costing

108. Aggregate company full costs have historically had an important role in regulation and, indeed, were the primary regulatory cost concept in telecommunications prior to this proceeding. Previously we had focused almost exclusively on total revenue requirements and rate base related issues.[62] The carriers were allowed virtual autonomy in determining how revenue requirements were to be satisfied among various classes of service.[63]

109. Full costs of operations include current operating expenses such as wages, salaries, fuel, maintenance, advertising and research. They also include annual charges such as depreciation and operating taxes. Operating expenses parallel standard accounting concepts of costs. That is, costs generally are recorded at original or historical values and are recovered over time, hopefully, in a manner consistent

[62] Total revenue requirements are comprised of the full costs of operations (expenses) plus an allowed rate of return on net plant and other tangible and intangible assets in service. Communications Satellite Corp., 56 FCC 2d 1101, 1131 (1975).

[63] 1 Kahn, *The Economics of Regulations*, pp. 54-56 (1970).

with their associated revenue flows. It is consistent with the theory of regulation that rate base items and operating expenditures disallowed by a Commission for ratemaking purposes should, in effect, be charged to the firm's stockholders.[64] However, disallowances (such as the revenue shortfalls discussed earlier) eventually have impact on a firm's cost of capital, particularly the equity component. In this case the important question is from which service or services, if any, are such costs to be recovered when there is a shortfall? When a firm serves a number of classes of users, each with varying demand characteristics, rate adjustments stemming from upward costs pressures would logically be directed toward those classes of users with the most inelastic demand, e.g., monopoly service users. In the past, before competition in telecommunications came to the fore, the problem of how particular increases in costs were to be handled was less acute. Generally, there were other downward cost pressures, notably those resulting from rapid technological advances yielding more efficient and cost effective plant. Furthermore, there existed ameliorative exogenous factors such as the nation's low inflation rates and productivity increases, and the relative structural stability of the telecommunications industry itself. Problems of rate levels for particular services and interservice rate levels were considered as secondary to the determination of overall revenue requirements.[65]

110. When either a carrier's rate levels or interservice rate relationships are at issue the allocation of costs among services becomes essential to the performance of regulatory functions. Thus, questions arise concerning the justness and reasonableness of relative rates vis-a-vis the cost of providing service. In this proceeding the major areas of contention center on the general appropriateness of FDC for such pricing and ratemaking purposes (especially the rationale for its use and its alleged compensativeness and efficiency consequences). There is also controversy herein concerning which specific FDC method(s) is appropriate under an accountability standard. In particular, should the historical nature of full costs and the alleged inherent arbitrariness of requiring distribution of certain common and joint operating costs according to FDC methods preclude their usefulness for ratemaking purposes? Furthermore, do efficiency and revenue contribution losses proximately result from such a distribution, and, if so, are these losses of a significant magnitude? Finally, when FDC methods are employed for accountability purposes, what distributive measure(s) constitute a proper basis for the assignment of costs?

111. The RD favors use of FDC for both ratemaking and accountability purposes. The RD describes FDC as follows:

> In a fully distributed cost (FDC) analysis, the totality of all historically recorded investment and operating costs for all services offered during a specified test period are first determined. In addition, the total historical volume of each service actually provided during the test period is determined from the carrier's records.
>
> Direct costs which can be identified for a particular service offering are segmented and attributed to the relevant service. The remaining common and joint costs are allocated among the services according to statistical and/or judgmental determinations as to the *proportionate use* which each service made of the facilities, personnel,

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[64] *Id.*, pp. 26-7, 31. *See also*, Garfield and Lovejoy, *Public Utility Economics*, pp. 48-56 (1964).

[65] For a discussion of the FCC's regulation of common carriers in the "precompetitive" era, see Garfield and Lovejoy, *supra.*, at pp. 194-5.

and operations supported by such costs. At the conclusion of the process, it is possible not only to compute a rate of return for each service, but also to establish *definitive unit costs* for each of the services offered during the test period, which can be used as a basis for determining the *appropriate cost-based price* for each service which would have satisfied the carrier's total revenue requirement—including cost of capital. The rates for each service may be computed so as to have contributed an equal rate of return on investment or each service rate may be computed to have produced different rates of return while the aggregate of all *satisfies the overall revenue requirement.* In all these calculations, appropriate factors for demand elasticities (including cross-elasticities among services) may be introduced. Finally, these *calculations may be used as a basis for setting future rates, with appropriate adjustments for market forecasts, projected demand elasticities, projected cost increments, etc.* (RD, pars. 106-107) (Emphasis added).

C. Marginal Costing and Pricing

112. Marginalist theories with their ties to "optimum social welfare" have a long history. Like most major evolutionary advances in conceptualization, these theories have evolved from the efforts of a number of writers. Clearly, the pioneering work of Jevons, Menger, and Leon Walras stand out regarding utility-oriented marginalism with its overtones for optimization. Jevon's followers, Edgeworth and Wicksteed, Weiser and Bohm-Bawerk of Menger's Austrian School, and Pareto of the Lausanne School's general equilibrium tradition, made notable contributions to marginalism, as did the Cambridge School of Marshall and such American writers as J. B. Clark.[66] What came to be addressed by some authors as the marginal cost pricing approach of neoclassical economics eventually tied together both demand and supply factors. Walras and Marshall were perhaps most noteworthy for their contributions to this synthesis. Within the context of general equilibrium, the relationships between demand and supply traced themselves through to the welfare of society as a whole: pricing theory and welfare were at last integrated. Economists often assume for conceptualization purposes that real world market situations closely parallel the constructs of the neoclassical competitive model. We note that under their assumed conditions, these scholars alone, apart from other social scientists and policymakers, would be in the unique position of being able to prescribe a social policy regarding pricing which was "best" not only for the firm or the individual, but for the aggregate public welfare as well. Unfortunately for economists, the constructs of neoclassical theory have not easily lended themselves to practical implementation. Underlying restrictive assumptions which lead to narrowly applicable results have subjected neoclassical theory to criticism of its precepts and, indeed, its relevance.

113. Despite inconsistencies with real world conditions, marginalism and marginal costing and their ties to social welfare still remain an intrinsic ingredient of the foundations of modern economic theory. Certain writers have adapted economic theory to more pragmatic conditions. However, others have furthered its hypothetical constructs. Writers like Robbins and Schumpeter went so far as to maintain that there exists a body of immutable "universal laws" of economic behavior that apply to all stages of capitalism. Such laws were unaffected by the particular social mores and institutions in existence at any particular time. Even those writers who were willing to bring cultural ele-

[66] Samuelson, *Economics*, Chapter 32, (1970). See also, Rima, *Development of Economic Analysis*, Chapters 11-17 (1967).

ments, externalities, and nonefficiency criteria into their analysis, still have the tendencies to embellish their recommendations with overtones of optimality.[67] Indeed, the RD maintained (to which Bell excepted) that "Bell's witnesses in this proceeding who have proposed LRIC as the appropriate basis for pricing do so in large part because of their view that it leads to a 'social optimum' " (RD, par. 102). In practice, of course, a compelling case can be made for any number of alternative professional approaches to pricing, such as accounting, financial, statistical, and legal. Moreover, policymakers concerned with legislative and other non-economic criteria must well weigh these concerns in reaching yet other pricing alternatives.

114. The RD describes the theory of marginal costing and pricing generally as follows:

> Briefly, this theory holds that the most economically efficient allocation and use of society's resources will be achieved when the price of each individual unit of goods or services is set equal to the actual marginal or incremental cost of producing that particular unit. It is alleged that such a pricing scheme will best force consumers to weigh the value of a public utility good or service against its actual costs, thus limiting production to the minimum essential level which the aggregate of all consumers finds economically justifiable. It was recognized at the outset, of course, that any practical application of this theory would require its modification, since for reasons of administrative and operating efficiency as well as equity among utility consumers it would not be feasible to charge each user a different rate for essentially the same goods or services. The resultant necessity of identifying appropriate objectives short of the particular "social optimum" initially contemplated, and of finding practical methods of applying marginal cost pricing theories in a real world environment (both of which involve value judgments outside the realm of economic theory) remains a source of continuing controversy both among economists and between economic theory and other social sciences.
>
> Initially, the concept of marginal cost pricing was applied primarily to the study of investment decisions required to satisfy a constant or steadily expanding demand; the emphasis was thus placed on so-called "long-run" marginal cost. . . . The application of the theory of marginal cost pricing to the privately owned regulated utility has been very recent; and its application to the relevance for the pricing of a mix of services supplied under both monopoly and competitive market conditions by a single integrated firm is perhaps a case of first impression in this proceeding. As is evidenced by the record herein, there remains much controversy with respect to any practical application of these theories, but particularly so in the latter case of the private firm engaged in both monopoly and competitive markets. The short-run marginal cost pricing rule is normally expressed in terms of imposing on the customers who demand service at the peak period the full capital costs for plant and equipment of the system. . . . Application of short-run marginal cost pricing theory in this manner leads to one "social optimum," with higher rates being charged for service at the peak than for off-peak service. Regulated telephone utilities have thus far opposed general application of this form of marginal cost pricing, citing *practical limitations* due to administrative and operating problems, *overriding considerations of equity* among customers, and *other factors beyond the realm of economic theory*.
>
> There appears to be a general consensus among economists that once the plant has been built its capacity should be allocated for use by pricing the service at the short-run marginal cost. The consensus breaks down, however, with respect to the addition of new plant or the replacement of old plant. Some economists argue that where plant must be added to provide a service, the service should then be priced at the long-run marginal cost of the added plant. Others argue that the service should be priced at the short-run marginal cost associated with use of the added plant. Those in the latter group appear to believe that the added plant should be designed so that the short-run marginal cost (utilization cost) of the plant will be the same as the

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[67] See, for example, Bator, "The Anatomy of Market Failure," *Quarterly Journal of Economics*, Vol. LXXII (1958), pp. 351-79; Arrow, *Social Choice and Individual Values*, (1951).

long-run marginal cost at the intended level of output, and that if output will vary over the plant life, the price should be set at short-run marginal cost in each period, being below long-run marginal cost when the plant has excess capacity and above long-run marginal cost when the plant capacity must be allocated among competing users. (RD, pars. 109-112) (Emphasis added).

115. In evaluating marginal costing and pricing, the RD (par. 115) notes that:

Bell's principal witness, Professor Baumol, claims on the record herein that fully allocated costs do not have economic significance, and that only incremental or marginal costs should be considered by the manager of the regulated public utility in setting rates for various services. The LRIC pricing rule proposed by witnesses Baumol and Bonbright represent Bell's attempt to apply marginal cost pricing theory to the pricing of certain of its telecommunications services.

116. The RD further states that:

There remains considerable controversy both among economists and between economists and members of other disciplines concerning the application of marginal cost pricing theory to situations and conditions which differ significantly from the publicly owned monopoly supplier of utility services, which was the situation assumed in the development of the theory. . . . There are several specific problems relating to the application of marginal cost pricing to the mixture of monopolistic and competitive telecommunications services offered by Bell.

The economic theory underlying marginal cost pricing was developed in the context of a monopolistic industry. Taking the theory on its own terms and accepting, *arguendo*, the value judgment that the particular social optimum that would result from the theory's application is somehow of particular merit, it is clear that the theory must be modified if it is to be applied to a competitive situation in telecommunications. According to the theory, if a monopoly charges its marginal cost for its output, the cost to society of producing that output is exactly equal to the price (for the last unit sold), and the equality maximizes some measure of benefit to society. If the firm is not a monopoly, no such maximization is necessarily made, for the simple reason that the marginal cost to the firm is not the same as the marginal cost to society.

There are several reasons for the inequality of cost to the firm and cost to society in competitive industries: first, the several firms all produce different combinations of output, with plant designed for their particular outputs. . . . Clearly, if this be so, the cost to each carrier is different, and no carrier can claim that its cost for producing an incremental output is that of the industry as a whole. But even if all firms in a competitive industry had identical plants, the marginal cost to one need not be the marginal cost to the industry as a whole. Put simply, if one firm increases its output, it may assume it will have no effect on the prices of the goods it purchases from other industries, and its other factors of production.

* * *

As previously noted, efforts to apply marginal cost profit maximization theory to public utility firms also engaged in competitive enterprises are a relatively recent development, and remain the subject of considerable controversy. At the outset, we note that in the case of the regulated public utility, profit maximization would appear to be contrary to public policy. One of the principal functions of regulation is to prevent exploitation of consumers through the setting of excessive rates. Proper regulation thus specifically forbids profit maximizing behavior on the part of the utility and specifically requires that the utility establish prices which will provide the maximum quantity of service consistent with its allowed rate of return. Yet, to the extent that a carrier has monopoly power, the equating of marginal cost with marginal revenue for the purpose of profit maximization will yield a price greater than cost for the ultimate quantity of service provided.

Economists do not generally agree on either the objectives of the managers of large unregulated firms, or the pricing rules managers use in meeting their objectives.

* * *

Theory of marginal cost pricing for utilities (setting marginal cost equal to price) attains the results its proponents claim (the "social optimum") only if other firms are maximizing profit, the utility prices all services according to the marginal cost

rule, and there is no overall revenue requirement for the utility. If these conditions are not adhered to, the pricing rule must be modified in some way—price must differ from marginal cost.

* * *

Whatever the motivation and practices of the unregulated firm, it is clear that the regulated utility operates under a different set of incentives. It can be shown with the rigor of mathematics that a utility subject to rate of return regulation may find it profitable to expand output beyond the level which an unregulated firm would produce. (RD, pars. 116-122) (citations omitted)

* * *

[I]t has not been conclusively shown that marginal cost pricing can be applied to one service without a subsidy from some other service or source. When economists suggest (as in this proceeding) the use of "inverse elasticity rules" for price discrimination among services or classes of customers to allow the company to meet its overall revenue requirement, they are suggesting that those customers with inelastic demand subsidize those with elastic demand. While it has not been established by probative evidence in this or any other case of which we are aware, it is commonly assumed by economists that the demand for monopoly services is less elastic than is that for competitive services.

* * *

[T]he relevance and utilization of marginal cost pricing in both regulated and unregulated firms may be found in the accounting procedures employed. Effective use of marginal cost pricing clearly requires detailed information on both marginal costs and marginal revenues for each product or service. Yet standard accounting systems (including the ones used in the telecommunication industry) typically do not provide such data. At best, they provide data only on average unit costs for particular product lines. (RD, pars. 126-127.)

117. The significance of this discussion relates to Bell's advocation of marginal costing and how such an advocation should be viewed. Bell is promoting an approach to competitive service pricing which is optimal in terms of Bell's viewpoint and which suits its pecuniary objectives. Thus, the "aura of optimality" associated with Bell's approach and theoretical marginal costing needs to be closely examined and understood. It is not at all clear that this has yet happened, despite the RD's entreaties along these lines (RD, pars. 102-105), and, indeed, Bell's own disavowal of ties between its approach and a social optimum (Bell Expt., pp. 46-49). In oral argument, for example, it was noted as part of a question posed by a Commissioner that "we could insist from a *socially optimal point of view* that it is efficient for all marginal costs to be identified in some way. All costs should be identified in terms of *marginal cost allocation* and that the prices [should] be set at or around that, and as long as the marginal costs are increasing that would be the correct decision would it not?" (T. 11598) (emphasis added). Bell's response emphasized that its ". . . objective is not to price at marginal costs or at Long-Run Incremental Costs. It is a method of analysis to determine the greatest contribution that you can make to the common costs." (T. 15598). Bell's "responses both in Brief and orally were found [however] to be not totally satisfactory . . ." (T. 15600). The Commission recognizes that a ratemaking philosophy having just *some* aspects of an "optimal approach" need not be optimal at all.[46] The record amply demonstrates that Bell's LRIC is not faithful to the theoretical postulates of marginalist theory. (We shall discuss this in detail in Section X.) Again, we emphasize that the Commission must weigh all proposals in light of its statutory objectives, not those of individual parties. Where such objectives coincide, we feel confident that their pursuit is in the public interest. Where such objectives con-

[46] For discussion of this "second best" problem in a regulatory context, see, Alfred E. Kahn, *Economics of Regulation*, Vol. I, pp. 69-70, 195-98.

flict, the broader interests, which we feel we represent, must prevail. In this instance, we cannot find that Bell's proposed LRIC meets our objectives of efficiency, nor does its proposal evidence properties which would otherwise serve the public interest, such as accountability. Even if a convincing case had been made that Bell's proposal would lead to greater economic efficiency, many other factors including those of a legal and social nature must be considered in our evaluation process.

118. Under the assumption that a faithful reproduction of LRIC *could* be constructed, it is well to examine LRIC's associated allocative features respecting their possible incorporation into a regulatory framework. The theoretical long-run involves a planning concept under which the firm is considered to be unencumbered by any of its historical investment or operating decisions. The firm can plan to employ whatever conceivable facilities and other resources it believe best suits its projected demand and managerial objectives. In the long-run the firm is in what is termed a "fully adapted position." That is, all inputs are variable, and all combinations of technology and factors of production are within its grasp. The firm is in a relatively unconstrained state. To be sure, common facilities exist in the long-run just as in the short-run. However, in the long-run these facilities are "common" only in a functional—not in a planning sense. They could be used for the expected demand of the various services in several manners. One could ask what additional facilities would be needed for the competitive services, assuming that monopoly service facilities were already constructed. Such questioning or logic, however, is irrelevant to cost allocation. The long-run planner is in the position of projecting demand by service when all costs are variable. He "knows" which services are expected to use which facilities and how much supportive activity ("overhead") is needed per unit of output. Finally, note that if total cost in this planning world is not projected to be covered by total revenue, the service in question would not be planned for. "Competitive necessity" in the short-run sense is of no consequence here. Moreover, all costs should be traceable, dollar for dollar, to each service without residuals. There are no direct costs. When actual events unfold, it is expected that these projected total costs "caused" by the individual services can be favorably compared to results from operations.

119. Of more concern is the problem of the allocation of "residual" costs resulting from pragmatic conditions. These residual costs may result, first, from differences between actual and forecast costs or, secondly, because the firm priced its services according to projected costs before it was in a "fully adapted" position (i.e., in the presence of existing fixed costs). In the first instance, operating performance may exceed or fall below that forecast. The marginal approach, being prospective and assuming perfect knowledge, does not suggest how the dollar value of revenue excesses or shortfalls generated by these circumstances should be accounted for in the determination of individual service rates, particularly for a multi-service, partially competitive firm. The latter instance, which we believe applies to Bell's marginal pricing methodology, ignores the vast existing plant of a carrier like Bell. The presence of fixed costs here implies a short-run situation. (As

we noted before, in the theoretical long-run all costs are variable.) The long-run, "fully adaptive" theoretical rules are not applicable in the short-run. Nevertheless, existing fixed costs must be accounted for and recovered.

120. The Commission recognizes infirmities in the marginal cost, long-run approach to pricing, and finds any strict translation of its procedures from theory to the practical telecommunications world infeasible. We find rates developed with only partial reference to a LRIC formulation to hold no particular advantages with regard to achievement of a social optimum. Additionally, we find that the freedom this approach grants Bell to allocate residual costs (resulting from deviations between forecast and actual conditions or between expected and existing plant) to the monopoly services to be violative of our accountability, equity and fair market objectives and responsibilities. We do find, however, long-run marginal costing's causational assignment of costs to be attractive from an accountability standpoint. In the sense that facility construction is undertaken to meet certain needs, we note that historical cost causation can be a measure of the acumen and efficiency of a carrier's operation when viewing actual results. Similarly, we find that the flexibility of the carrier to develop rates commensurate with expected costs aligns with the efficiency objective. The marginal costing features should be melded into any statement of proper ratemaking principles.

121. Short-run marginal costing and pricing received favorable treatment from both Bell and the RD, albeit for different applications. Bell recommended its LRIC (which is shown to be essentially an incremental, short-run concept below) and burden test for use as part of its basic service philosophy of pricing (Bell P.F., pp. 26-119). The RD, on the other hand, suggested that the "most direct and immediate application of the concept would appear to be in the peak/off-peak pricing of monopoly services . . ." (RD, par. 145). Of course, according to Bell, marginal costing should be a *pivotal* aspect of ratemaking, where as the RD viewed marginal costing in a more corollary role to a basic FDC approach. No detailed discussion of short-run marginal costing is appropriate here since the concept and both of these viewpoints are explored more extensively in the next section. However, some further comments regarding the general efficiency, equity, and accountability aspects of short-run marginal costing should be made in concluding our discussion here.

122. Bell takes exception to the RD's examination of short-run marginal costing, especially with regard to peak-off-peak pricing. "While peak-off-peak pricing is of concern in the rate structure of network services, it has no application to dedicated full-time private line services . . . Bell advocates off-peak pricing for MTS . . . where the MTS rate structure is at issue" (Bell Expt., p. 57). The Commission recognizes the difference between the choice of a marginal customer class by time of day where cost differences exist, and the arbitrary choice of classes of services to be treated as marginal users. In the first instance, the Commission may agree with differential pricing for peak-off-peak users. However, the arbitrary choice of a select group of (competitive) services which are treated as marginal users where users of other services are treated differently is patently discriminatory. In

the latter case, we cannot approve the loading of short-run overhead, depreciation, and other fixed costs on "nonmarginal" users.[69]

123. We thus find disparate treatment of potential marginal customers to be unjust and unreasonable. We do not agree that the carrier should be free to choose any service it desires as the "marginal offering," nor will we accept an overall ratemaking philosophy which incorporates this freedom. In the interests of efficiency, we may permit preferred treatment of certain services if cost economies will be realized and can be demonstrated. However, a showing must be made that full costs will be covered within some reasonable time certain. Further, the relationships to full costs must also be established.

X. BELL'S LRIC VERSUS NEOCLASSICAL THEORY

124. The RD characterizes Bell's LRIC as follows:

> Bell's LRIC proposal is an attempt to apply marginal cost pricing principles on a selective basis to certain of its service offerings (e.g., private line services subject to competition). Bell does not, in either its LRIC proposal or its existing rate structure, attempt to apply marginal cost pricing to the type of services and for the purposes for which the theory was initially proposed and for which it has been brought to the most advanced stage of development; i.e., to the peak/off-peak pricing of monopoly public utility services so as to achieve the most economically efficient production of such services. Furthermore, Bell's LRIC proposal does not contemplate that the overall pricing of its monopoly services will be based on the same long run incremental cost basis as would its competitive services. Instead, the monopoly service prices would be set at whatever level is required to satisfy Bell's total revenue requirements (including all its historical costs as well as projected but non-allocated incremental costs), after the competitive service prices are set on the basis of forecast long run incremental costs and forecast "burden" analyses.
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> Bell's LRIC proposal contains certain features apparently intended to circumvent some of the more obvious practical problems (e.g., the proposed use of incremental cost forecasts to avoid the difficult if not impossible task of determining true marginal costs from Bell's books of accounts, and the proposed use of a "burden" test to alleviate concerns that the incremental pricing scheme inherently implies subsidization of one service by another). However, besides failing to satisfactorily resolve these problems, the LRIC proposal appears to erode some of the basic principles of marginal cost pricing and to further exacerbate its basic problems. (RD, pars. 128, 129).
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> A primary objective and responsibility of regulation, on the other hand, is to hold the carrier fully accountable to its customers for its investment, operating, and pricing decisions; and, if necessary, to disallow costs which are not justified or rates which are either excessive as compared to legitimate costs or are unlawfully discriminatory. Under the LRIC approach, virtually all effective methods for establishing and maintaining accountability would be eliminated. The Commission's role, in the first instance, would be to review Bell's future-oriented cost, demand, and revenue forecasts.
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> Stated somewhat differently, under conventional regulatory philosophy and statutes, both the right and the responsibility for important management decisions such as the choice of alternative investment strategies, service offerings, and rates are afforded, in the first instance, to the carriers' management. While the Commission is afforded some limited control over capital investments and proposed tariffs, its primary function as surrogate for the competitive marketplace is to conduct ex post

[69] We will carefully scrutinize Bell's dedications of facilities as "direct plant." Dedication of common facilities and resultant cost allocation implications do not impact on our evaluation of the equity of the cost distribution process, since clearly such dedications are subject to managerial discretion and manipulation. We will not, therefore, permit the carrier's dedication of facilities to various services to circumscribe our responsibility to evaluate allocations of so-called "directly attributed" plant.

facto evaluations of these management decisions as reflected in subsequent market and earnings developments, and to make such corrections to the carriers' ongoing programs as are found necessary, pursuant to these evaluations, to protect the public interest. These ex post facto evaluations require the existence of a record of actual vs. projected results, and a means for determining what changes if any would have been required in management's original decisions to have satisfied the requirement that tariff rates and conditions be just, reasonable, and non-discriminatory. (RD, pars. 131, 132).

125. The underlying principles of long-run incremental cost (Bell's application of marginal cost)[70] were described by Bell in Docket 16258 (Bell Exh. 25 and 26). Bell described incremental cost as referring to "the change in total cost occasioned by the supply of an additional output of service or a lesser amount of service" (Bell, Expt, p. 28). The measure of change is accomplished by discounting to present value the stream of estimated future net cash outlays made by the firm resulting from the commitment to supply a particular service over the "long-run." These principles stem from neoclassical (or marginalist) theory. An important step in the application of these principles, however, is defining what is meant by "long-run," since in theory, the concept relates to that future point in time at which costs become variable, and for which there are no restrictions concerning the choice of any factors of production, including restrictions engendered by historical plant facilities.

126. It is manifest from the record that Bell's concept of "long-run" does not conform to this definition. Although the Bell concept includes estimates of capital costs required to permit adaptation of plant capacity to the size of the market (Docket 16258, Bell Exh. 24; Docket 18128, Bell Exh. 3), there are, nevertheless, inherited plant costs which are considered fixed and which are not planned to vary during the forecast period. Thus arise the terms "fungible" and "non-fungible," as well as "non-attributable" costs, which in effect, give recognition to the constraints that reality places on the corporate planner in estimating true long-run incremental costs (RD Appendix C, par. 45). As Dr. Melody testified in Docket 16258, the firm "sets prices in a state of partial adaptation to the capacity that it has inherited from the past, and therefore is not considering all the long-run effects of its decision to supply service." (CCB, Exh. 52.)

127. As indicated in the RD (Par. 128), Bell proposed to apply its LRIC techniques only to its private line services. This results in a mixed approach to costing (i.e., Bell's basic service philosophy), with forecast costs being used in setting rates for competitive services and historical costs being used to determine monopoly rates. Since future costs are predicted by Bell to be lower than current and historical costs, incremental costs sum to less than total costs, and a shortfall in revenue is necessarily created when prices are set at Bell's LRIC (i.e., revenues covering only incremental costs would be insufficient to cover total costs, including cost of capital).[71] Further, under its basic ser-

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[70] Incremental cost is a more general concept than marginal cost. Incremental cost is the cost ascribable to any specified change in volume of output, or service, whereas marginal cost is the limit of that increment, as the change in volume approaches zero. In economics, marginal cost refers to the change in cost associated with the additional output of one unit. Thus, for practical application, marginal cost considers a change in volume generally too small to be of any practical significance.

[71] It is noted that the revenue shortfall from pricing at LRIC occurs either from making the assumption that economies of scale do exist or from a failure to consider inherited costs when the firm is a "going concern," or both.

vice approach, Bell proposes to add a markup above the LRIC floor it determines for private line services. Rates are set at a level, which in Bell's judgment, will yield an "optimum contribution" to other services (RD, par. 113). Any portion of Bell's total revenue requirement not covered by revenues from the private line services becomes the responsibility of MTS and WATS ratepayers. Bell claims it relies on economic theory in support of its utilization of marginalist techniques (see Bell Expt., 89), but there is no theoretical or record support for selective application of these techniques.

128. Bell asserts that application of incremental analysis to private line services is designed to measure true "economic" costs, i.e., those costs which vary with a change in the level of output. Yet incremental analysis is not designed to address what is to be done with "unallocable" common or fixed costs.[72] When asked how the Commission should account for common costs which are unattributable to any specific service, Dr. Baumol responded: "by definition those unattributable common costs never enter into incremental costs, and therefore, they can cause no ambiguity in the incremental cost figure" (T. 10397). Bell stated in Exception 41 that a LRIC study determines the total changes in costs (including any effects on common costs) and revenues over the long run as a result of offering a service at a particular rate, as compared with alternative rates." Clearly, costs which remain unattributable as a result of not changing in response to alternative rates lie outside the theoretical construct of incremental costing. Thus, in determining the level of contribution which private line services make towards covering unallocable common fixed costs, Bell relies on judgment—not neoclassical theory. The level of contribution is described as "the largest contribution which is prudent or reasonably practicable, taking into account market conditions, rate relationships, and other relevant ratemaking factors" (Bell Expt., par. 39).

129. With these departures of Bell's LRIC from neoclassical theory in mind, we note a considerable difference in holding that "the vast weight of economic theory is clearly on the side of marginal or incremental costs . . ." (Bell Expt., par. 87), and saying that the vast weight of economic theory is clearly on the side of Bell's selective and judgmental application of incremental costing techniques. Accordingly, Bell's comment that the LRIC methodology "optimizes" contributions from the competitive services with "benefits" flowing through to the users of the basic services whose rates are thereby lower than they would otherwise be (Bell, P.F., par. 46), cannot draw support from neoclassical theory.

130. Even assuming, *arguendo*, that Bell presented acceptable explanations for its departures from neoclassical theory, there are still a number of questionable areas which would require further justification. One such area is the inability to provide the Commission and its staff with any acceptable means of verifying results. Bell claims that its "retrospective accountability analysis" serves this purpose by providing historical information to the Commission. Bell's retrospective accountability analysis involves assigning to a service category all directly attributable embedded costs on an incremental basis (i.e., those

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[72] Examples of these costs include executive salaries, general advertising, some sales and marketing costs, printing, consultant fees, as well as plant items used in common by two or more services (such as poles, service equipment and vehicles), which are not attributable to any specific service.

costs which would cease to occur under the hypothetical condition of discontinuance of service). The analysis is similar to FDC Method 7, except that Bell's retrospective accountability analysis does *not* redistribute the remaining unattributable costs (the "tenth category") to all services, as does Method 7.

131. Dr. Baumol testified that LRIC forecasts and retrospective accountability analysis do not come up with directly comparable figures. As he states, "[t]here is no way in which they could" (T. 10307). The purpose of this study is to provide *some* ability to monitor the differences between the attributed costs of a service and the revenues provided by that service—before and after a change in rates (T. 10308). Therefore, observation of the results for any time series during which there is no rate change would be of little significance for the purpose of accountability. Second, there would be little significance in any spread between revenues and attributable costs, because it must be remembered that no portion of common and fixed costs are allocated to the service being analyzed. In this regard, we note that one of the advantages of FDC is that it attempts to provide revenue and cost figures for individual services which can be compared for the purpose of evaluating the performance of the service over time, in relation to other services and to the firm as a whole.[73]

132. We note also the problems of forecasting in reality as opposed to forecasting in economic theory. Dr. Melody stated during oral testimony (T. 8731), that the application of marginal cost forecasting is hampered by all the constraints which history places on the ongoing firm. These include the existence of large amounts of inherited plant and the necessity of making investment decisions based on inherited plant. The need to depart from theory in making everyday business decisions dictates why, for example, it is uneconomical to immediately replace all older, low capacity high cost facilities with newer, high capacity lower cost facilities.

133. Other questions remain concerning the reliability of forecast costs in general due to the influence of exogenous factors, such as the results of future labor negotiations, inflation, the health of the total economy, oil embargos, and the like. These factors must be anticipated by the forecaster, and too often the subjective perceptions of the forecaster influence the results. Any unanticipated changes in these factors would cause shifts in the position of the long-run curve. The Commission, of course, could not hold a carrier accountable for such shifts. For example, Mr. Eastmond testified (T. 11579) that Bell preferred the use of expense to investment ratios for estimating certain future expenses, rather than actually projecting current trends for expenses into the future. To have performed the latter would "be anticipating future inflation, and Bell feels that improvement in productivity would offset the inflationary trends." This testimony was given by Mr. Eastmond in 1972. The assumption was made that inflation for the 1971-1974 period would be near that of the 1958-1968 period. In retrospect, the period from 1971-1974 was characterized by the most serious inflation since World War II. Other economists also

[73] We find merit in Dr. Wein's often quoted phrase: "[a]t best, therefore, a FDC analysis provides a signal, a somewhat cloudy one to be sure, that rate levels of various services are out of line with the standard that each service should earn enough to cover its fully distributed costs plus a fair return on its rate base." (CCB, Exn. 50, p. 107, Docket 16258.) We agree that FDC results are not precisely accurate.

were unable to forecast inflation during this period. Consequently, it is our conclusion that present forecasting techniques are not yet refined enough to provide reliable information to this Commission for carrying out its statutory mission.

134. Major inputs to Bell's long-run analysis are its market studies. The RD was critical of Bell's market studies. It concluded, in part, that "until Bell can show that it can provide market estimates which are consistently accurate, it is doubtful that the Commission can adopt a regulatory policy that relies exclusively upon such [incremental analysis] even if such a policy were otherwise desirable" (RD, Appendix B, par. 39). Bell maintains (Bell Expt., p. 160-1) that such a conclusion is unwarranted and unsupported by the record. Bell claims that its LRIC analysis does not depend wholly or rely exclusively on such market study results. While it appears that the statistical method of customer selection is technically satisfactory, the fact still remains that observations which comprise the survey are judgments of Bell Account Managers. We have no means of knowing what biases, if any, may exist in the estimates of the Account Managers or what non-sampling errors may have been introduced (T. 10065-67, 10089, 10091). Bell introduced testimony that the method employed is superior to direct customer surveys and that there was insufficient data for econometric analysis (Bell Exh. 17). We find this of little value. There is no proof that accuracy is improved by use of one method over another. The only recourse left to us is to review the actual versus forecast results, more than five years after the fact. Such review shows that portions of the forecasts vary in degrees of accuracy. However, the bottom line interstate *Telpak* revenues were overstated by more than ten percent. In fact, the expected level of interstate *Telpak* revenues was not realized until after 1973 (Monthly Report No. 4, December, 1971-74). We thus agree with the Recommended Decision (RD, Appendix B, pars. 37-39) that these errors are sufficient to merit skepticism.

135. As part of its incremental costing approach, Bell employs a "burden test" allegedly to determine whether cross-subsidization exists between services. The results of Bell's burden test, however, also depend upon a number of judgmental inputs.[75] Dr. Baumol provided a description of how the concept of the burden test works (T. 10276): "[I]magine that a service is discontinued. Several things occur: costs that otherwise have been incurred disappear, revenues which would have otherwise been derived disappear, other services now obtain revenues which they otherwise would not have obtained. Costs which those services would not otherwise have incurred now are incurred. You take all of these into account and see if you come out ahead or behind to determine if there has been a burden." The determination of cross-elasticities between Bell's interstate services (and between Bell's services and those of other carriers) is critical to the results of the burden test. The record provides evidence that Bell is unable to measure cross-elasticities with reasonable accuracy[76] and the effect of un-

[75] It is a simple but sometimes overlooked point that the burden test does not measure whether a service is or has been a burden. It is not a test of actual events, rather an estimated test as to what one might expect if all the estimates for future incremental costs are correct (T. 2102). The burden test, of course, cannot be faulted for what it was not designed to do, but in light of its name and this Commission's need to perceive the existence of cross-subsidy on the basis of acceptable actual data, it is important to make this distinction.

[76] Several questions concerning the validity of the development of Bell of elasticities for WATS were raised in the recent Commission decision in Docket 19989 (*WATS*, 59 FCC 2d 671 (1976)).

derestimating cross-elasticities may result in a competitive service passing the burden test at a rate level that, in fact, would be non-compensatory (T. 12571). Bell also asserted that including the cross-elastic effects in the burden test necessarily makes the test harder to pass (T. 12187; 12517; 12571-2). Yet judgment influences results in this instance as well since, if it is determined that the diverted use to substitute services causes costs greater than the new revenues obtained by the substitute services or if other communication services are considered by Bell to be complements rather than substitutes, then including measures of cross-elasticity does not make the test harder to pass. Moreover, the decision as to which plant is designated as fungible or non-fungible will affect the burden test, because the more plant designated as non-fungible, the easier it will be for a service to pass the test (T. 10276).

136. Problems arise, in theory, from implementing a capacity cost concept, since it is not consistent with the theoretical notion of long-run which allows the planner to overcome constraints arising from inherited plant or large unit investment. Thus, there is validity in characterizing Bell's LRIC concept as being an "additive" concept (i.e. using capacity unit investment costs versus the development of a long-run total cost curve under differing assumptions). The record is also unclear as to what the correct plant fill factors should be. This measurement is important, because the higher the estimated fill factor, the lower the resulting average incremental cost. As Dr. Baumol indicated, there would be difficulty in deriving fill factors (for use in the burden test) for the system as configured under the alternative assumption of not having provided a service (T. 10323).

137. In summary, we find that Bell's modification of marginalist or neoclassical economic theory so as to incorporate the constraints imposed under a system of revenue requirements regulation significantly changes the assumptions made under theory. The long-run cost concept is primarily a planning concept—a guide to corporate planners for making the decision of what plant to set up in order to produce at minimum cost the expected level of output. Once investment decisions have been made and funds are tied up in fixed-capital equipment, the firm operates under short-run conditions. The existence of the large pool of embedded investment affords the Bell System little investment flexibility of the type envisioned under the theoretical long-run. Moreover, Bell's process is heavily dependent upon judgmental decisions which cannot be verified or tested by the Commission. The ability of the Commission to review, correct and change rates later based on another uncertain forecast, is not sufficient to meet our statutory responsibilities. In a regulatory environment, the risks of revenue shortfalls should not by design be borne by monopoly users. [77] Furthermore, we find that Bell's approach is violative of the objectives of fair and

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[77] DOD has proposed the use of long-run average costs (LRAC) as the appropriate reference point for determining compensatory rates which are not a burden on other services (DOD P.F., p. 25). DOD maintains that if all resource costs are included, LRAC should equal LRIC. We reject LRAC for many of the reasons that led us to reject LRIC. For example, it must be based on subjective forecasts of future events. Also, it differs from theory insofar as average costs are not defined for a multi-product firm (Docket 18128, T. 10301; Bell Exh. 20, p. A-5), and as described at DOD P.F., p. 25, it is not a true long-run concept. DOD itself admits that "it is extremely difficult to determine the LRAC for an individual service in a multi-service organization." (DOD P.F., p. 28.) It is our finding that LRAC would be too unreliable for practical use.

equitable treatment of all users, and cannot be reconciled with the objective of ensuring fair market rules.

XI. EVALUATION OF FDC

A. General

139. Accounting data and both unit and total costs developed from such accounting data, have historically provided the basis for the bulk of management's production decisions. Of course, decisions involving the evaluation of management's performance or the comparison of a project's actual and expected results have traditionally utilized accounting information. Dynamic decision making also has shown a similar dependence. Included here are decisions of both a current or "real time" nature, and those concerning future events based on projections and forecasts. Moreover, forecast data itself often consists of extrapolated historical conditions. Where pricing of an existing product is required, accountants have designed costing systems to generate unit costs for the most complex conditions. Indeed, major areas of accounting theory, such as process, job order, and standard costing, deal with the provision of the information needed for dynamic pricing decisions.

140. The realization that prices in private industry must be set *before* all costs were determined (i.e., historically recorded) was not an original thought of economists. Accountants and financial analysts have "looked backward" only when the decision involved necessitated that they do so. (They do not wear "historical blinders.") Although many accounting reports such as the balance sheet and income statement are intended as surveys of the *results* of operations and management's decision making, other [78] accounting information provides part of the basis for these decisions.

141. The most widely used cost accounting methods and associated statements are designed to report the *full costs* of operations for the particular economic unit of interest. However, such "adjusted reports" as variable costing income statements and information provided by many managerial accounting techniques use less than full cost information, when needed for specialized decisional conditions. [79] Accountants recognize the value of such information on an intermittent basis. However, the expectation that either *all* recorded costs will eventually be covered by revenues or that these costs will accrue to the firm's shareholders remains.

142. Other professions also hold that all costs must be covered by revenues. MCI noted, for example, that "all responsible economist writers on the subject of determining the fully allocated costs of products or services in multi-product or multi-service firms readily acknowledge that, while the task is not free of difficulty, it must be done" (MCI R.E., p. 70). MCI pointed out that Nobel Laureate Paul

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[78] We take notice of such works as Hendrikson, *Accounting Theory* (Richard D. Irwin, 1970), Chs. 1-4, Neuner, *Cost Accounting* (Richard D. Irwin, 1973), Chs. 1-13, 16-24, Garrison, *Managerial Accounting* (Business Publications, Inc. 1976), Chs. 7-19, and Pyle and White, *Fundamental Accounting Principles* (Richard D. Irwin, 1975), Chs. 22-25, in assessing the historical and current relationships between accounting and managerial decision making.

[79] See Copeland and Dascher, *Managerial Accounting* (1974), Chs. 3-14; Drebin, *Managerial Accounting* (1972), Chs. 2-12.

Samuelson in his well-known text, *Economics* (1st ed., pp. 510-11), wrote:

> [Y]ou will turn to the cost experts and probably ask for the unit cost of producing each product in question. . . . There will be plenty of headaches in aiming at any sort of figure. For example, how shall the administrative and plant overhead costs be allocated between different products? Or if a given process simultaneously creates joint products like meat and hides, how shall the costs be allocated between them? Or if a building will last for many years, how much should be charged against current operations?
>
> Headaches, or no headaches, it is the duty of the accountants to come out with some sort of answer as to unit costs. (MCI R.E., 70, 71.)

Similarly, MCI noted that Corwin Edwards in discussing the Robinson-Patman Act in *The Price Discrimination Law* (1959) (p. 586) said:

> When costs are relevant, the language of the statute circumscribes the discretion of the [Federal Trade] Commission and the courts as to the types of cost that can be considered and as to the permissible methods of analysis. . . . The purpose of this language was explained by the sponsors of the Act in the debate in Congress. Concerned lest a respondent might take certain business at prices based on the out-of-pocket costs of an additional increment of activity, those who drafted the bill sought to preclude any defense of such a price concession on the basis of a comparison of this incremental cost with a cost for other business computed to include all the overhead charges. Overhead costs were regarded as properly allocable on an equal basis to all business done.
>
> Many of the respondents in price discrimination cases were engaged in the sale of a considerable number of commodities, each bearing its own prices. When the price differences applicable to one of these commodities were challenged, a cost defense required a segregation of the cost pertaining to that particular commodity. (MCI R.E., p. 71.)

143. As we have otherwise noted, Bell, despite its reliance on marginal costing for purposes of this proceeding, likewise recognizes that full recorded costs must be covered. Indeed, its basic service philosophy may be viewed simply as a special, implicit approach to the distribution of full recorded costs. As noted above, elements of its arguments related to competitive services stress the efficiency of less-than-full cost pricing, but the substance of Bell's basic service philosophy is based on a full cost recovery constraint. For example, Bell disavows marginal cost pricing for *all* its services and, indeed, opposes strict use of this concept even for the pricing of competitive services. It is important to note that given a full cost recovery constraint, decisions regarding how much each service will contribute are equivalent to a division among such services of the full costs of operation. Whether such decisions are made through cost allocation procedures such as Methods 1 through 7 or through the basic service philosophy that Bell has proposed, the objective is still the same: all costs will be recovered (Bell Expt., pp. 25, 27, 30). In practice, Bell defers to the "discipline of full costs" both in its overall and individual service pricing designs. First, let us examine full costs as they relate to Bell's overall pricing philosophy. For the aggregate of its services, Bell's deference to the constraint of covering full recorded costs is illustrated by its statement on an FDC ceiling for MTS rates as suggested by other parties (see, CCB Exh. 7, Docket 18128 and FCC Staff Exh. 52, Docket 16258). In discussing the proposed MTS ceiling, Bell notes:

> In addition to the fundamental, theoretical, and conceptual flaws in any such use of fully distributed costs, there are *formidable practical objections* to these proposals by the Bureau witnesses. It is clear that if a carrier is to meet the essential objec-

> tive of earning its overall allowed rate of return, a necessary corollary of the proposal to place an FDC ceiling on MTS is that the carrier must seek to establish rates for other categories of service, including competitive private line services, which will yield revenues for each such service equal to the allowed overall rate of return applied to the FDC investment for such service. In other words, FDC would then become the standard of propriety for the rate level for each service category, and it would be not only a *ceiling for MTS*, but also a *floor* for each of the other services, including the *competitive* services (Bell P.F., p. 51) (emphasis added).

It is manifest that Bell would not urge that limitations on monopoly services prices constitute *both* a ceiling on monopoly service rates and also a floor on competitive services charges unless it felt that recovery of full recorded costs was a binding priority or constraint on its price structure alternatives. This was confirmed at oral argument:

> COMMISSIONER ROBINSON: . . . Should we put the rate of return constraint on the monopoly service and say none of the monopoly services can earn more than the system as a whole?
>
> MR. PERLBERG: If you do that then you are effectively putting a Fully Distributed Costs *floor* on the so-called non-monopoly services.
>
> COMMISSIONER ROBINSON: Now how can that be? If you tell us they do not constitute a burden on the system, that presupposes that monopoly rates do not have to be higher by reason of the competitive services.
>
> If they do not have to be higher, then why should not we put a rate of return constraint on the monopoly services to make sure they are not earning more than they need to by virtue of these competitive services?
>
> MR. PERLBERG: It depends on how you determine that constraint.
>
> If you determine that constraint effectively by a Fully Distributed Costs study and basically have two pots, one dividing it between the monopoly services and the competitive services, then effectively you are making a Fully Distributed Costs study.
>
> COMMISSIONER ROBINSON: No, it is not a floor. It is a ceiling. The *ceiling is on the monopoly return* or on the monopoly services, and then *you can charge for the competitive services whatever you want*, whatever is not burdensome for you.
>
> You can go down to Short-Run Incremental Costs or anything else.
>
> MR. PERLBERG: But that still effectively puts the Fully Distributed Costs floor *because you still have the background of a total, overall revenue requirement for the firm.* (T. 15604-15605) (Emphasis added).

144. Let us now turn to the second situation noted above—that of Bell's individual service pricing. It is manifest that Bell is not a true "marginal cost pricer" with regard to setting individual service rates. If no ceiling were imposed on monopoly service rates, Bell could look to these services for recovery of the bulk of their "residual costs." These residual costs would include all costs not recovered by its marginal cost based rates for competitive services. However, Bell recognized that even its monopoly customers have certain price limitations on their demand for services. Thus, in deference to these and other "relevant rate-making factors," Bell disavowed any allegiance to true marginal cost pricing for competitive services:

> The RD inaccurately implies that Bell advocates setting prices equal to marginal costs for competitive services, even though Bureau witness Wein admitted that Bell witnesses were not advocating marginal cost pricing. In fact, Bell does not advocate setting prices for competitive services equal to marginal costs, but advocates setting rates for these services above LRIC so as to achieve the largest practicable contribution from these services to permit the basic MTS to be provided at rates as low as practicable (Bell Expt., p. 14) (Citations omitted).

145. Hence, it may be seen that Bell is neither an overall nor an individual service advocate of the strict use of marginal costing for price determination. Furthermore, as has been demonstrated earlier, it cannot be inferred that there is anything particularly "nonarbitrary" in the obscure and judgmental pricing approach it does employ. On balance, Bell does adhere to the "discipline of full recorded costs recovery," albeit its unique approach to recovery of full costs differs from the classical design of cost accounting systems (under these systems the aliquot cost share for each service would be proportional).

146. Other parties besides Bell find the RD's adherence to full costing for all services somewhat onerous, and argue that the FDC methods are replete with "arbitrariness." These parties agree with the use of the "contributional logic" Bell proposes to apply to certain selected services.[80] For example, Bell noted that various economic witnesses for the other parties testified regarding the invalidity and arbitrary nature of FDC allocations. . . . These witnesses included . . . Dr. John W. Coughlan, a certified public accountant experienced in cost analysis procedures, including those for regulated industries (Docket 16258, NAB Exh. 3, pp. 1-18; T. 21200-05, 21215-17, 21345)" (Bell P.F., p. 148). Dr. Coughlan used a meat packing plant illustration where the basic carcass and most of the cost of preliminary work on it constituted "common" or "joint costs" (Docket 16258, NAB Exh. 3, p. 11). In discussing common costs Dr. Coughlan appeared to support Bell's contentions concerning "contribution:"

> It is by now commonplace in cost accounting that *all* allocations of the common costs among the various joint and by-products are arbitrary. It is by *now widely accepted by cost accountants* that the basic profit maximization criterion is that total revenues for all the products put together must exceed total costs by as much as possible. In deciding whether a particular joint or by-product is waste or scrap and therefore not worth further processing, cost accountants now generally compare the revenues to be derived from further processing of that product with the special processing costs. Provided that such further revenues exceed such special processing costs they generally conclude that profit maximization requires continued processing of that product since the product at least covers its special processing costs and makes some *contribution* toward covering the common costs and earning a profit on the overall product line (Docket 16258, NAB Exh. 3, p. 12).

147. In the transcript cited by Bell, however, Dr. Coughlan also appeared to support Bell's ultimate deference to the "discipline of full recorded costs." On the one hand, Dr. Coughlan recommended that program transmission rates should not be charged "what the market will bear," but only a contribution. On the other hand, he agreed that "somebody has to pick up the tab:"

> Q. On page 12 of your testimony, Dr. Coughlan, in the first full sentence, you state that it is now widely accepted by cost accountants that the "basic profit maximization criterion" is that total revenues must exceed total costs by as much as possible.
>
> Would you apply that basic profit maximization criterion to the program services' rate levels?
>
> A. . . . I don't disagree with your point at all. (T. 21205.)

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[80] As discussed above, Bell's approach may theoretically be of benefit to monopoly service users. This would occur if competitive service rates exceed marginal costs, and if the less than full cost level of these rates prevented the loss of competitive service customers and their contributions to common costs. Assuming *arguendo* that these conditions existed, they still would not, of themselves, constitute sufficient support for the Commission's adoption of Bell's basic service philosophy, because of the need to consider all of our objectives and responsibilities.

Q. But is it not your position that the Bell System should seek to obtain the maximum profit consideration from the program transmission services?

A. Well, I suppose perhaps in the interests of the stockholders, the Bell System should try to obtain the maximum consideration, but as a regulatory prescription, I wasn't necessarily advocating that point at all. (T. 21206.)

PRESIDING EXAMINER: . . . I take it that you would *not advocate that Bell charge whatever the market will bear*, in terms of rates for program transmission service.

THE WITNESS: That is correct, sir.

PRESIDING EXAMINER: All right. Now then, they should charge, in your opinion, something less than that.

What are the criteria which you say militate that they charge less?

THE WITNESS: Well, let me put it this way, Mr. Examiner, that in providing a *valuable public service*, as broadcasting presumably does, if the Commission feels that is a very valuable public service, that the objective then ought not to be to squeeze the last dollar of profit out of that category of service. . . .

PRESIDING EXAMINER: Well, do you think the airlines provide a valuable public service?

THE WITNESS: I would think they do, sir.

THE PRESIDING EXAMINER: And the railroads? And the public truckers? And steamship companies?

THE WITNESS: I would hope that they all provide a valuable public service.

PRESIDING EXAMINER: Well, do you believe that they do?

THE WITNESS: Yes, sir.

PRESIDING EXAMINER: I mean, are they in a similar public service category, as you have used the term?

THE WITNESS: Yes, sir.

PRESIDING EXAMINER: And educational activities?

THE WITNESS: Yes, sir.

PRESIDING EXAMINER: Well, then, would you expect also that the *same rules should militate in favor of lower rates*, that is, lower than the maximum which might be achieved for those entities and activities?

THE WITNESS: Well, Mr. Examiner, I just said that it might make sense for the Commission to do so, and you asked me if I thought *it would make sense in the case of broadcasters*, and I certainly agree with that, and there might be some of those other categories you mentioned, where it would certainly make sense to demand less than the very last dollar of profit that could be had for them, and I get the impression, for example, that the Commission tries to protect the MTT class of service in this same context.

So I am agreeing that the Commission might well do exactly what you have said, sir.

PRESIDING EXAMINER: Well, if the Commission takes care of all these special categories that we have enumerated, *somebody has to pick up the tab* which represents the difference between what is recovered and what is permitted as an overall revenue requirement by the regulatory agencies (T. 21207-09) (emphasis added).

THE WITNESS: Yes, sir.

BY MR. RASMUSSEN:

Q. Dr. Coughlan, you would agree that *some service has to bear the fully allocated and the embedded costs*, wouldn't you?

A. Well, that seems like a reasonable proposition, yes, sir (T. 21212) (emphasis added).

148. In summary, it appears that most of the parties concur that full recorded costs must be covered by Bell's various services, although

they disagree regarding particular cost distributions among these services.[81] The RD favors proportional distribution, while Bell, NAB, and other parties follow a more "selective" approach.

149. We find recovery of full recorded costs to be consistent with the public interest as we have discussed above. Further, since we find no merit or basis which warrants the special treatment sought by a number of parties, we rule that a proportionate distribution of all recorded costs best furthers the underlying objectives of the Act. In the discussion below, we will consider the relative merits of the full cost methodologies in general in light of such objectives.

150. The RD addressed several of Bell's objections to FDC as a ratemaking standard (RD, par. 147). (For the most part Bell is in agreement with the RD that FDC methods are appropriate for accountability purposes, albeit each expresses different preferences regarding the particular FDC method to be employed.) To Bell's objection that full costs are historically derived (rather than estimated from forecast data), the RD states that FDC *could* be derived for a future period using projected data if these were found preferable for ratemaking. However, the RD maintained that forecast data[82] has been unreliable in the past, as evidenced by the DDS, TAT-5 and TAT-6 cost estimates (RD, par. 148). Pending improvements in forecasting techniques and data developments, the RD urged that historical data be used to provide the basis for cost estimates and rate level support. Regarding questions raised about the economic significance of average costs for a multiproduct firm, the RD noted that there is both theoretical support and extensive evidence of the use of average costs in decision making (RD, par. 149). To the criticism that FDC does not provide an infallible or unquestionable rationale for allocating common and joint costs among the various services on an economically sound basis, the RD maintained that such costs are *inherently* arbitrary (RD, par. 150). That is, *all* costing methods of record must contend with this difficulty, not just FDC approaches. The fact that plausible alternatives exist does not, of itself, cast doubt on the RD's FDC (Method 1) approach. The RD alleged that, in general, FDC Methods are more explicit and unbiased, and result in more equitable distributions of common and joint costs than the Bell-proposed, marginal cost based (LRIC) alternative.

151. With respect to FDC's purported lack of economic significance, the RD notes that its suggested relative use allocation base finds considerable professional support, when applied in such circumstances as peak period distribution of costs (RD, par. 151). To the Bell argument that FDC fails to recognize the benefits of economies of scale and demand characteristics, the RD maintained that FDC intrinsically distributes scale benefits (to the extent they may be assumed to exist) in proportion to present relative usage of facilities. Furthermore, the RD found that FDC methods can easily accomodate demand information to the extent that such information is available and technically sound (RD, pars. 152-153). The RD concluded its reply to these Bell criti-

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[81] A notable exception is the Airline parties' "Accommodation Theory," discussed above, under which certain shortfalls may purportedly pass directly to Bell stockholders. (See Airlines BSE, pp. 46-52).

[82] Forecast data is discussed in Sections X and XIII.

cisms by maintaining that Bell itself used FDC analysis for its precompetitive era tariff filings for other purposes. The RD noted that although Bell is currently advocating competitive service departures from full costing, it still retains the full cost approach for its interstate services in the aggregate. That is, Bell's basic service philosophy is based on a full cost design, even though it contains a marginal costing component for its competitive services. The RD also maintained that FDC studies can provide an ongoing, periodic point of reference for evaluation of the efficiency of resource allocations and for monitoring rate levels. Unlike marginal cost studies, the RD noted that FDC analyses have a supportive base in the data already available in the Uniform System of Accounts, and can best provide the measure of cost responsibility needed for accountability purposes.

152. Bell responded to the RD by emphasizing that its major objection to fully distributed costing was not its historical nature, which was emphasized by the RD, but FDC's failure to reveal *significant data* concerning future pricing alternatives (Bell Expt., p. 84). Bell noted that "not only must relevant cost data be prospective, but the record shows that *proper analysis* must appraise the effect that the rate under consideration would have on total operating costs. . . . The record shows that future costs are espoused by Bell because they are the *only* costs which are relevant for ratemaking purposes. . . ." (Bell Expt., p. 84-85) (emphasis added). Bell alleged that FDC is inherently arbitrary and lacks a foundation in economic theory, and it must, therefore, be precluded from use as a ratemaking methodology. Finally, Bell included failure to recognize changes in costs resulting from changes in volume, and the absence of demand and cross-elasticities in its formulation as important deficiencies of FDC (Bell Expt., pp. 4-5).

153. Bell takes exception to the RD assertion that *both* LRIC and FDC involve arbitrary allocation decisions. As noted earlier, the RD stated that use of LRIC based prices for competitive services leaves a large residual of unattributable costs (including historical costs) which burden monopoly users, whereas FDC distributes these costs proportionately among the services (RD, par. 150). Bell replies that "there are *many* possible bases of [FDC] allocation which can lead to widely disparate results . . ." (Bell Expt., p. 89) (emphasis added). Furthermore, Bell alleged that the magnitude of such unattributable costs which must be borne by MTS users would be increased by use of full costing (Bell BSE, p. 13-16).

154. Bell does not directly address the need for a uniform costing methodology for all services that is implicit in the RD's arguments. To the contrary, Bell claims that its special treatment of competitive services results in efficiency and other benefits. Bell does not, for example, address the obvious question of why it does not make overall (aggregate) use of its long-run incremental cost philosophy. Nor does Bell state the reasons why monopoly users cannot be considered the "marginal customers." Bell acknowledges that it has not advocated strict use of marginal cost pricing for its competitive services, and that if its "interstate rates were [all] to be set merely at incremental costs, the resulting total revenues would fall short of meeting overall revenue requirements" (Bell Expt., pp. 52-53). "Strict marginal cost pricing insures that *every unit* consumed yields the purchaser benefits at

least as great as the cost of the social resources needed to produce the unit . . ." (Bell Expt., p. 55) (emphasis added). Implementation of this marginal theory by Bell would have efficiency overtones and would also imply it relies on a "social optimum"[83] objective. However, "*neither* this concept nor pricing at marginal cost are advocated by Bell" (Bell Expt., p. 55) (emphasis added). These incongruities in Bell's logic are important, since they leave serious doubts as to whether Bell's pricing philosophy can be any more economically efficient than other methods of ratemaking. This topic is discussed below.

155. The major assumption made in distinguishing between competitive and monopoly services for pricing purposes under Bell's basis service philosophy is that competitive customers would be lost without special pricing treatment. The result of this customer loss would be idle facilities and the loss of these customer's revenue contributions above incremental costs. However, let us assume, *arguendo*, that idle facilities once used by lost competitive customers would quickly become fully utilized through the growth of monopoly services, given the magnitude of these services and their historical expansion. The "per unit" marginal philosophy cited in reference to Bell's arguments earlier would then apply equally well to marginal units of such services. In such a situation the RD would be correct in its contention that the "arbitrariness inherent in *all* procedures for allocating such [residual] costs [is] both of less consequence and more properly treated in the FDC approach than in the LRIC approach" (RD, par. 150). That is, if the potential loss of a particular service's customers were not an overriding concern, then logically all customers should be treated alike. This logic would apply to the distribution of residual costs, and it is acknowledged that FDC results in a proportionate and more equitable spreading of such costs than marginal costing. Bell does not address this situation.

156. Also of significance is the fact that Bell does not trace its advocation of a marginal costing approach to a "social optimum" objective or to the fulfillment of the Commission's public interest responsibility. Bell's arguments rest on the aforementioned loss of competitive customers with the assumed result being idle facilities. Even if one agrees with Bell's assumption, only in an economic sense might the public interest possibly coincide with that of the Bell System. However, Bell acknowledges that it is not pursuing the optimal conditions of the lofty world of theoretical marginal costing (where LRIC provides a nonarbitrary allocation of *all* costs in the aggregate, and where heretofore unattainable levels of social welfare are reached). One cannot, therefore, ascribe any of the appealing results of theoretical economics to Bell's approach. Moreover, Bell has failed to treat all its customers equally under its pricing philosophy. It has down-played the contributions of the MTS and WATS services to its overall growth and the sustenance of technological advance derived from such services. The

[83] "Optimality" or "social optimum" as used in the context of neoclassical economics connotes the existence of the highest levels of social welfare. Bell uses the term "optimum" to characterize the contribution Bell claims to obtain from private line users when it sets rates "in due regard for other ratemaking factors" (Bell Expt., p. 59). Bell considers this contribution to be the "maximum" that it can achieve. This is a subjective judgment since it depends on Bell's estimate of the importance of "other ratemaking factors." Bell's "optimum" or "maximum" may not correspond to the numerically maximum contribution that can be achieved when rates are set in strict accordance with demand and supply functions.

"arbitrariness" of FDC that Bell so frequently cites serves to describe its own pricing approaches as well.[84]

157. As noted earlier Bell supports fully distributed costs for certain purposes but not others. This extends to its recommendation that FDC be part of a "sound regulatory framework" for assessing the reasonableness of interstate service rates (Bell BSE, pp. 47-57). Bell is "fully cognizant that the Commission needs appropriate benchmarks upon which to evaluate the reasonableness of the rate levels for the various interstate services" (Bell BSE, p. 47). However, Bell does not support a "rigid, mechanistic formula" which would produce "vast inefficiencies" and "greatly increased cost burdens" for all communications users. Thus, Bell believes FDC should be used as a "point of reference" or "signal" for the purpose of rate adjustments.

158. Bell supports reporting FDC results under both Method 2 (on a separations/relative use basis) and Method 7 (on a historical cost causation basis), so that the "Commission will be able to apply its judgment to the *range* of return levels indicated . . ." (Bell BSE, p. 53) (emphasis added). Bell, as we do, recognizes that ratemaking decisions require "the balancing of a number of factors relating to costs, demand, and other pertinent ratemaking considerations" (Bell BSE, p. 53). Thus, Bell, citing legal rather than economic support, suggests that a "zone of reasonableness" for rates and rate levels can be established which the Commission can employ in making an assessment of lawfulness. "The Commission cannot be wedded to a *single* criterion . . ." (Bell BSE, p. 54) (emphasis added). Bell in its own assessment of costing methodologies, in relation to our stated objectives, recognized the interplay of the legal and economic considerations we noted above. Hence, Bell appears willing to utilize full costing in overall methodological proposals in deference to the legally oriented accountability objective. It is here that both the RD and Bell appear to be on common ground. In passing, we note Bell's use of FDC Method 7 principles in performing its retrospective accountability analysis. An examination of both this analysis and Bell's reasons for support of Methods 2 and 7, in preference to Method 1, is left for the discussion below.

159. The Commission agrees with Bell (Bell BSE, pp. 52-57) that a "zone of reasonableness" can be established for the evaluation of rates and rate levels based on the results of the FDC methods of record and other factors. Indeed, we have relied on this nature of logic in making our findings below in Section XII. Further, we are in substantial agreement with Bell that assessment of the reasonableness of rate levels and relationships should not be wholly tied to a single methodology. However, for the reasons stated herein, we hold that FDC methods should be the *standard* of ratemaking, rather than merely a "benchmark" as Bell advocates. A proper FDC method or methods should establish rates which might then be adjusted commensurate with "other relevant ratemaking factors" properly documented and supported. We hold that tariff filings should reflect their overall impact and effects, and should be based on data employed in a consistent manner between services and over time. Bell must exhibit methodological consistency and supply comparable supportive materials for future

[84] See Section X, *infra*.

rate filings of all the various Bell services in accordance with the guidelines established herein. To hold otherwise would be inconsistent with our accountability and equity objectives. We nevertheless recognize that there may be special circumstances which warrant a departure from our full cost standard. This is discussed below in Section XIII.

B. FDC Methods of Record

160. There were seven methods addressed in the record that overtly distribute the full recorded costs of operations. (As noted above, Bell's basic service philosophy is also a method of implicitly distributing full costs). Bell described the basic differences of the seven methods thusly:

> The procedures under Method 1 followed the basic methodology of the 1964 seven-way cost study, except that in the FDC studies subsequent to the 1964 study the allocations of costs for interexchange circuit plant were not based on an inventory of specific facility assignments to individual services. As agreed in meetings with the Commission Staff, the allocations for such plant (except for video and certain wideband services) were based instead on the embedded cost of types of facilities available for use by the various services, according to the length-of-haul characteristics of the individual services. The general approach of Method 1 corresponded to principles underlying the Separations Manual. . . .
>
> Method 2 involved several modifications of the allocation procedures followed in Method 1 with respect to the treatment of minor investment, certain expense, and miscellaneous revenue items. . . . Revised allocations methods were used for plant under construction, exchange plant costs of WATS access lines, general expenses, general department expenses, traffic engineering expenses, sales expenses, operating rents, and miscellaneous operating revenues. Such revised allocation procedures were also utilized in Methods 3 through 6, and in part for Method 7.
>
> *Methods 3 through 7* were approaches to the allocation of the embedded costs associated with the interexchange circuit plant on the *basis of the historical cost responsibility* of services. The measurement of historical cost responsibility involves determination of the extent to which increases in total embedded costs resulted from the provision of a particular service over the period of years such service was offered. *Methods 3 through 7, in their objective, were significantly different from the concepts underlying Methods 1 and 2*, which *are based on averaging techniques that essentially disregard historical cost causation*, particularly with respect to the incurrence of costs associated with the interexchange circuit plant.
>
> In Method 3 the costs for line haul and carrier terminal facilities were assigned to various non-MTS services on the basis of an estimate of the overall average of added costs for such facilities incurred per added circuit mile over a period from 1964. The approach of Method 5 was similar to Method 3, except that the effect of length-of-haul (mileage band) characteristics was reflected and additional refinements were made by including data on Associated Company (as well as Long Lines) plant. In Method 4 the costs associated with the older types of circuit facilities were allocated on the basis of an analysis of the estimated circuit requirements for the various services that existed at the time the circuit plant was originally constructed. Method 6 was a refinement of Method 4 in that it utilized the capacity costs of coaxial and radio systems as the basis of allocations to the non-MTS services of the costs for these facilities. Method 6 was thus designed to estimate the embedded costs of the additional plant that had been constructed to serve the additional facility requirements imposed as a result of providing these services.
>
> Method 7 represented an approach to the allocation of embedded costs which involved the initial assignment of directly attributable costs among the services and the segregation of certain costs of general applicability in an unassigned category. Initially, those historic costs directly attributable to the individual services were assigned to the respective service categories. The costs not so attributed, as indicated below, constituted the unassigned category. . . . In arriving at the results shown under Method 7 in the 1969 and 1971 FDC studies, this unassigned category of costs was allocated to the service categories according to the investment and

expenses that had been directly attributed to the services. The costs in the unassigned category determined under the Method 7 procedures included: (a) the difference in interexchange investment for coaxial and radio facilities between total investment and capacity investment, and the related expenses and taxes; (b) all investment, and related expenses and taxes, for motor vehicles, other work equipment, and furniture; (c) testing expenses associated with commonly used plant; (d) certain commercial (e.g., sales and advertising) expenses; and (e) all general and general department expenses (Bell P.F., pp. 130-133). (Citations omitted.) (Emphasis added.)

161. As discussed above, Methods 1 and 2 follow the general approach corresponding to Separations Manual principles. The underlying allocative basis of these principles can be traced to the "relative" use concept. Like any other basis of allocation, relative use is not free from controversy or distortions in certain instances. However, analyses based on relative use do indicate demand patterns and facility assignments which provide valuable evaluative information. We will review certain objections raised by the parties against Method 1 and the relative use allocative base below as well as the attractiveness of such costing procedures.

162. The RD used Method 1 as the basis of the FDC studies it ordered Bell to conduct for all services (RD, pars. 216-219). Bell, as noted previously, is opposed to use of any FDC method for ratemaking purposes, although it does suggest use of certain FDC data as a point of reference for Commission decisions (Bell BSE, pp. 50-53). Bell does not consider FDC Method 1 appropriate, however, even for these purposes. In opposing use of Method 1, Bell objects primarily on the grounds that Method 1's relative use concept results in assignment of older facilities to newer and growing services (e.g., under Method 1, pre-1960's open wire, voice frequency cable, and K carrier facilities are assigned to TELPAK). (Bell P.F., pp. 134-36, Bell BSE, p. 41). Bell also states that Method 1 may be distorted by disproportionate growth factors that may develop between services, and may result in the generation of improper "signals" or incentives for management decision making. Most of these infirmities are described in the context of Bell's suggested historical cost causation basis of allocation and its particular emphasis on Method 7. From this perspective, Bell feels, for example, that Method 1 has little utility for "tracking" cost trends or for use as a "benchmark" of cost responsibility:

> Method 1 results in significantly distorted cost figures because it allocates a disproportionately large segment of the high cost older interexchange facilities to the private line services, although the construction of these facilities clearly antedated the initiation or principal growth of the private line services. (Bell BSE, p. 41) (Citations omitted.)
>
> • • •
>
> In an FDC study apportioning all the common costs between MTS and the private line services on the separations methods (under the so-called "relative use" or "relative output" standard), the portions of the overall rate base assigned to MTS would be affected by the relative rates of growth of the two types of services. Thus, there will be changes in the indicated FDC rate of return for MTS, not as a consequence of any change in the conditions of furnishing that service, but rather as a consequence of changes in the supply of other services. Hence if an FDC rate level standard were imposed, the Bell System, in deciding how far to promote the growth of the private line services, would need to take into account the effect of this growth on the assignment of costs to the MTS component of its overall rate base. This could interfere with management decisions on private line rates designed to achieve an optimum contribution to the MTS users and could result in higher, not lower, rates to MTS users. (Bell, P.F., p. 136) (Citations omitted.)

163. Bell noted certain specific characteristics of Method 1's allocative approach which it feels are "clearly infirmities." An example, Method 1's treatment of plant under construction, was referenced during oral argument by Mr. Perlberg:

> Now, you would think that you would construct a new plant to meet the growth requirements of services. . . . [The] television and the audio/radio services experienced negative growth for a considerable period of time.
>
> MTS and WATS are growing substantially. Now, if you are going to look at fully allocated costs, and if you are looking at historical cost causation, you would say, well, MTS and WATS should have the most plant under construction.
>
> You know, why do you construct plant? It is to anticipate your growth requirements, but these are the results under Method 1.
>
> Method 1 winds up irrationally allocating more plant under construction to television and audio/radio than to MTS and WATS.
>
> The Commission in the WATS case said WATS was the most rapidly growing of all the interstate services, and yet under some of the irrational procedures that ignore causation WATS gets the least proportionate amount of plant under construction. (T. 15622.)

164. The Network Parties agree with Bell that Method 1 does not appropriately take cost causation responsibility into consideration. Similarly, they agree with the allegation that all FDC studies fail to account for future costs and use of facilities presently in place. Excepting Methods 6 and 7, the Network parties maintain that the FDC methods fail to give recognition to the capacity of plant in place, and in making an allocative determination do not consider what use may have been planned for the facilities in question. These methods therefore may result in present users of one service being charged with costs incurred to meet other services' *future* needs (Network Parties pp. 62-66). Referencing our decision in the *Private Line Cases*, the Networks, like Bell, point out that improper "signals" for management decision making may be generated if management must act in observance of Methods 1-5 procedures:

> If an approach such as Method 6 or 7 were not used, fairness would dictate that the carrier construct only for immediate requirements, an approach that, realistically, would make no sense operationally or from an economic viewpoint. *But the fact that it makes sense to construct for the future does not mean that current users should bear the full annual cost of such construction.* Indeed, this Commission has held that they should not. . . . (Emphasis in original.)

165. Finally, the Networks assert that "several of the [FDC] studies (particularly Methods 1 and 2) fail to measure 'actual' usage . . ." (Network Parties Br., p. 63). However, the Networks feel that Methods 6 and 7 achieve some success in correcting the following "obvious" (from their standpoint) misallocations of cost (Network Parties Br., p. 66):

> — Whereas the 1967 FDC Method 1 study shows a high video interexchange investment (based on the so-called "separations" procedure), a special study conducted by AT&T in 1968 shows *actual* video usage to be much less; yet the subsequent FDC Method 1 studies—designed for jurisdictional purposes—fail to take account of these special AT&T studies and continue to show the same large video interexchange investment as in 1967;
>
> — Similarly, whereas the 1967 FDC Method 1 study shows a large investment in video local channels, the same 1968 AT&T special study of television shows *actual* local channel investment to be much less; yet again, the later FDC Method 1 studies continue to show the same high local channel investment. (Network Parties Br., p. 66) (Emphasis added.)

166. As indicated, Method 7 was the FDC approach that Bell found most compatible with its own ratemaking concepts. Bell, for example, employed certain Method 7 costs in conducting its retrospective accountability analysis. Bell also noted that "whereas the LRIC and burden studies were prospective in their orientation, it was recognized that it would be appropriate to provide historical information that would be of assistance to the Commission in determining how these prospective analyses have in fact worked out" (Bell P.F., p. 108).

167. Bell's retrospective analyses involved "a uniform, periodic analysis of realized revenues and incurred costs directly attributable to the service categories" (Bell P.F., p. 108). Bell maintained that these directly attributable, historical costs "may well include a substantial proportion of common costs, since it is generally agreed that it is possible to assign a large portion of the common costs on an incremental basis" (Bell P.F., p. 109). "The assignment of operating expenses and net investment to the service categories followed procedures for determining directly attributable embedded costs developed in connection with Method 7 . . ." (Bell P.F., p. 111). Bell only included the directly attributable costs developed in Method 7 for its retrospective accountability analysis. The unassigned category of costs was *not allocated* among the services. Bell felt its adapted use of Method 7 determined costs "provided the most sensitive method for *tracking* the revenue-cost relationship applicable to a given service" (Bell P.F., p. 111) (emphasis added.)

168. Bell also found Method 7 attractive in making its recommendations for "assessing the reasonableness of the rate levels for the interstate service categories" (Bell BSE, p. 47). Bell suggested that "the Commission might wish to employ historical data using allocative techniques as part of its rate evaluation process. . . . Pending formulation of revised FDC procedures, the FDC methodology to be utilized in reporting to the Commission should consist of Method 2 (as representative of a "separations" approach) and Method 7 (as representative of historical cost causation for each service category)" (Bell BSE, p. 48). Bell, from its own perspective or vantage point, suggests that Method 7 be combined with a separations (relative use) approach for rate evaluation purposes. Bell also appears to believe that revisions to FDC procedures are in order.

169. In supporting Method 7, Bell said that it believed "that the Commission should have before it an FDC Method that is based on the principle of historical cost responsibility" (Bell BSE, p. 52). Bell felt that Method 1 could not be used to give evidence of this responsibility:

> We are recommending adoption of Method 7 because of the usefulness of its cost finding procedures for other pertinent ratemaking purposes. Under Method 7 the historic costs directly attributable to the individual services are assigned to those services, and the residue of unattributable costs is then allocated on the basis of the investment and expenses that have been directly attributed. The results obtained under Method 7, before the allocation of the unattributable residue, are useful for determining accountability on a retrospective basis and as one of the standards for the compensativeness of rate levels. Method 1, on the other hand, cannot be used for these purposes. (Bell BSE, pp. 52, 53) (Citations omitted.)

170. We find that FDC Methods based on historical cost causation are attractive for ratemaking and especially for "tracking" purposes. Where the procedures for determining causation are consistent be-

tween the planning (prospective) and evaluative (retrospective) periods, we feel that causational based methods can provide the basis for a program of "continuing surveillance." Based on the evidence before us, however, we find that, at best, Method 7's procedures must be made more consistent with a true *historical* causation allocative base, must be less susceptible to managerial interpretation and manipulation, and generally must be clarified and delineated to the Commission's satisfaction. These alterations and clarifications should be made in accordance with our discussion of Method 7, below.

171. The causational features of Method 7 appear ostensibly to incorporate some of the attractive characteristics of marginal costing. However, certain infirmities of Method 7 have been illustrated in the record that preclude its immediate use for these purposes. We have noted herein that theoretical LRIC would involve assignment of all expected facilities and costs according to projected service usage of input factors that management foresees on its "planning horizon." In this decision making mode no factors would be unassignable from a causational standpoint, although, functionally speaking, it is true that some plant and other factors would be *used* in common. (Likewise, on this "horizon," one could speculate that certain additional increments of plant would be needed for additional units of service, but such speculations would be irrelevant to the decision making process.) As we have discussed, this ability of marginal costing to intrinsically allocate common and other costs is attractive from an accountability standpoint. Method 7 shows promise of incorporating this feature of projected analyses into an FDC framework. However, it would appear illogical to characterize any method as having *historic* causational aspects if such method, in making an initial assignment of plant, did not do so in accord with its *expected uses*. Method 7 is deficient in this respect.

172. The RD, apparently observing the general logic of historical causation, concluded that Method 7 *must* involve projections. The RD noted that "since Method 1 is generally based on actual operating results, it does not have the uncertainties associated with forecasts of the near and distant future *necessarily required* by FDC Methods 3 through 7 and eliminates the questions of possible biases affecting such forecasts" (RD, Appendix C, par. 87) (emphasis added). Bell, however, maintains, in opposition to the conclusions of the RD, that Methods 3 through 7 "make use of actual data from past periods to measure historical cost responsibility, and to that extent are based more on 'actual operating results' than Method 1" (Bell Expt., p. 241). Bell insists that "the recommended decision is wrong. Method 7, they said, involves projections. All of these methods and all of the FDC Methods 1, 2, 6 and 7, they all involve historical costs and an allocation of total historical costs" (T. 15623).

173. If Method 7 does not involve projections of intended uses of facilities (and, perhaps, other features of historic causation such as fixed assignments of plant by service which are made at some point in time for later comparison, review, and possibly updating when compared to actual results), this method is really only masquerading as being based on historical causation. There is evidence in the record that Bell's *actual* assignment procedure is one of merely looking back

from the present time to a past year and then making "Method 7 determinations" of directly attributable plant and costs "after the fact." An approach of this nature is totally unacceptable from the Commission's standpoint since it is violative of our accountability equity, and fair competition objectives. It is not based on current use (which can be immediately substantiated) or on currently projected use (which can be documented for later review). Furthermore, such assignments would, in part, reflect *dedications* of plant in accord with management's objectives (e.g., the "arbitrary" assignment of the least cost facilities and their associated revenue requirements to competitive services leaving the "residuals" to be covered by MTS customers). These "dedications" could, no doubt, conveniently change to reflect shifting *company* criteria in complete opposition to the aforementioned objectives and responsibilities of the Commission.

174. Initial questioning of Bell at oral argument regarding Method 7 indicated that this method did not, indeed, hold closely to the logic of historical causation. It was there shown that Method 7's basis of allocation was "current usage" determined by Bell on an "after the fact" basis:

> MR. PERLBERG: . . . Method 7 says, look, we had certain directly attributed costs. This, in relationship to your question, Commissioner Robinson, we were able to attribute to the various services over 80 percent, 82, 83, and so on.
>
> COMMISSIONER ROBINSON: What is the basis of the direct assignment?
>
> *Is this original causation?* I mean, some plant changes over time, presumably usage changes, some which might have been used predominantly for MTS might be used subsequently for private line services.
>
> MR. PERLBERG: If it is switching used by private line service, it would be attributable to that private line service, *what you are doing right now.*
>
> COMMISSIONER ROBINSON: Okay, so it is *not historical but it is current usage.* (T. 15623-24) (Emphasis added.)

175. Bell also indicated that Method 7 plant assignments, prior to their reexamination by the Commission, do not exhibit the fixed nature that they must for Commission accountability purposes. Bell revealed that Method 7 was similar in certain respects to "relative use" methods which, of course, do not involve fixed plant assignments.

> COMMISSIONER ROBINSON: What I am asking is if the books are changed when a plant is put in and allocated to a particular service, but then its *pattern of use changes*, say after 10 years—then *are the books changed to reflect* current—
>
> MR. PERLBERG: If it is *unique* to a particular service *and is used currently by that service, it is assigned to that service* under the directly attributable costs method.
>
> We do treat the circuit plant which is sometimes subject to change on a daily or monthly basis, and that circuit plant is assigned according to the length of [haul] characteristics of the particular service.
>
> That is the *same whether you use Method 1, 2, 6, or 7.* There is no difference in that. *All* these methods, incidentally, are the so-called *relative use methods.* We have the same number of circuit miles in 1, 2, 6, and 7. (T. 15624) (Emphasis added.)

176. Additional questioning at oral argument confirmed the variability of plant assignment infirmity of Method 7. Management appeared to have unwarranted "assignment flexibility" under Method 7, as it is currently employed, so as to be able to manipulate an individual service's dollar share and assignment of total plant. This could be accomplished, for example, by taking readings of current usage at selected

points in time, or by management questioning itself concerning assignments in a certain preconceived fashion:

> COMMISSIONER ROBINSON: It does not follow that if I have a piece of switching gear, and I know that *when I buy that it is basically going to be used, say, 50 percent for one service and 50 percent for another*—it does not automatically follow that that would be directly attributable to those two services on a *50-50 basis.*
>
> MR. PERLBERG: *You have to ask the other question,* would I buy it in that size if I did not have that other service?
>
> But if you are ordering that piece of equipment specifically for serving two services, and it would be a *different size if you did not have that other service,* then it *would be indirectly attributable costs.*
>
> COMMISSIONER ROBINSON: Then the whole thing would *fall under the common costs?*
>
> MR. PERLBERG: No.
>
> COMMISSIONER ROBINSON: I say if you cannot make that decision, it is a *meaningless question.* You have a piece of equipment that is designed to handle so much traffic, and let's say you just never asked the question, what kind of equipment you would get if you had only one of the two services.
>
> MR. PERLBERG: Basically, you are able to attribute that under Method 7 to what we call directly attributable costs.
>
> COMMISSIONER ROBINSON: The *second question,* if that *ratio changes over time,* does *that get adjusted?*
>
> MR. PERLBERG: *Yes.*
>
> COMMISSIONER ROBINSON: It becomes 75/25 percent?
>
> MR. PERLBERG: These analyses, we are now making them every year. . . . (T. 15626, 15627) (Emphasis added.)

177. Any FDC method or methods used for accountability purposes must also have a clearly defined allocative base in addition to the features mentioned heretofore. Since Bell maintains that "all of these methods 1, 2, 6 and 7 are relative use if you are going to use a broad term," it seems clear that what is meant by "relative use" and other allocative bases must be precisely delineated before surveillance procedures can be initiated. Furthermore, there must be clarification of the evaluative steps that will be involved in surveillance, along with techniques to be used for updating assignments if projected results are found to be grossly out of balance with actual results. Such requirements for exacting specifications of FDC methodology is clearly demanded by our objective of clarification of market rules.

178. We find that the need to update plant assignments and to provide indications of current usage under a program of continuing surveillance appears to require continued carrier submissions of Method 1 results. These Method 1 results will reflect current demand patterns which may be grossly at variance with historical assignments. Of special concern, of course, would be multi-use plant assigned, on a projected basis, to a particular service. Method 1 should, however, be reviewed to determine whether it might employ more appropriate "comparable use units" for the Commission's purposes. Refinements to the method should ameliorate its peculiar infirmities such as those discussed above regarding plant under construction and actual usage of facilities compared to relative usage.

179. For purposes of findings concerning the rate levels and rate relationships at issue before us, we find data submitted under Methods

1 and 7 to be sufficient to provide a "zone of reasonableness" which, when combined with other ratemaking factors, allows us to make a determination of lawfulness. For the reasons discussed above, however, we find that Bell's services, future rate levels and relationships (and changes thereto) must be supported by Method 7 data. Method 1 data also will be required. Elaboration of guidelines for revisions of such procedures which will align Methods 7 and 1 with the objectives and responsibilities emanating from the Act is discussed in Section XIII.

XII. THE LAWFULNESS OF BELL'S RATE LEVELS

A. Section 201(b):

180. In light of the foregoing, we now decide whether the return levels for Bell's major interstate categories of service at issue herein have been and are just and reasonable within the meaning of Section 201(b) of the Communications Act, excepting TELPAK (which is discussed in the context of Section 202(a) below) and WATS (which is being refiled on November 8, 1976).

181. The RD concluded that the return levels for Bell's competitive services are unlawful insofar as they are below the level of its minimum overall cost of capital on a FDC Method 1 basis (RD, par. 204). Further, the RD held that MTS rates should be designed so that it yields earnings of no more than the lesser of the maximum currently allowed Bell rate of return, or the overall rate of return actually being realized. Private line rates should be designed to yield no less than the minimum allowable overall rate of return (RD, par. 217). Additionally, the RD concluded that it is unjust and unreasonable to require users of Bell's MTS and WATS services to contribute revenues in excess of the overall allowed return level so that the company may earn its total revenue requirement (RD, par. 183). This, according to the RD, defines cross-subsidization.

182. Bell and several user group parties except to the RD's reliance on FDC Method 1 as the sole basis for determining the justness and reasonableness of the return levels at issue herein. These parties argue that the Commission may properly utilize long-run incremental costs, or a variant thereof, to determine the lawfulness of return levels for Bell's competitive services under Section 201(b).

183. We have found above that a strict marginal costing approach to pricing cannot be practically implemented under real-world telecommunications industry conditions. We have also found that Bell's LRIC analysis is neither theoretically acceptable nor commensurate with our statutory mandate to ensure just, reasonable and non-discriminatory rates. We must accordingly conclude that LRIC cannot be used to determine whether the return levels for Bell's major interstate categories of service are just and reasonable within the meaning of Section 201(b).

184. The relative characteristics and merits of FDC Method 1 and 7 were also outlined earlier (see Section XI). It was recognized that although not ideal, these two methods can provide a valuable guide for determining the justness and reasonableness of present and past return levels and relationships at issue herein. The results of analysis of return on investment in accordance with FDC Methods 1 and 7 provide

a "zone of reasonableness" which enables us to evaluate the lawfulness of Bell's return levels. Although not necessarily perfect, these methodologies together are sufficient to identify cross-subsidization and provide carrier accountability. We find this approach consistent with long-standing Commission policy which recognizes the central role of costs in determining the lawfulness of rates, but which, where appropriate, also recognizes the role of other non-cost factors.[85] Accordingly, pending application of our guideline methodology employing Method 7 (discussed *infra* in Section XIII), we will rely on FDC Methods 1 and 7 to delineate the bounds from which we may determine the justness and reasonableness and therefore the lawfulness of Bell's rate levels.[86]

185. Bell's most recent data in the record shows for the twelve-month period ending September 30, 1975 that an 8.5% return was earned on its total interstate investment.[87] During the same period the share of investment allocated to MTS earned 8.7% on Method 1 and 7.5% on Method 7. When compared to Bell's total interstate return on investment, it cannot be said that MTS customers are paying rates that are so excessive that they are patently unjust and unreasonable. On a Method 1 basis the MTS rate level is only slightly in excess of the overall level of return. Under Method 7 the MTS return is a whole percentage point less than the system-wide return. We recognize that in light of the relatively large percentage of revenues MTS generates vis-a-vis the other services, a small excessive MTS return could cross-subsidize competitive services. However, the record herein does not indicate that such cross-subsidization in fact exists. Accordingly, we conclude that based on the latest available figures Bell's MTS return level appears lawful under Section 201(b) of the Act.[88]

186. With regard to the lawfulness of MTS rate levels for prior periods, we note that Method 7 studies were not available before 1969. The original Seven-Way Cost Study showed a 10.0% return on investment allocated to MTS for the twelve-month period ending August 1964.[89] The overall return on Bell's interstate investment was 7.5%. In light of this disparity there is substantial question as to whether the MTS rate level during that period was just and reasonable. However, by 1967 the MTS level of return decreased under Method 1 to 8.0% compared to an overall return of 7.5%,[90] and, by 1969 when Method 7 results first became available, MTS displayed a range of levels, relative to the system-wide average, comparable to those existing today. In that period MTS earned 8.4% under Method 1 and 7.1% under Method 7, compared to a 7.8% overall return.[91] Accordingly, we conclude that between 1964 and 1969 MTS return levels appear to have been unreasonably high. However, since 1969, the difference between the MTS return level computed under Method 1 and the system-wide

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[85] *See* Private Line Rate Cases, 34 FCC 217 (1963); 34 FCC 244 (1964).

[86] The phrases, "return level," "rate of return," and "return" are used interchangeably with respect to a service category. They refer to the percentage return on investment allocated to the service. *See* also fn. 1, *supra*.

[87] Bell BSE, Appendix A.

[88] We are, nevertheless, presently considering the exceptions to the Initial Decision of the Administrative Law Judge in Phase II of Docket No. 19129, FCC 76-44 (released August 2, 1976). This proceeding will determine, among other issues, the appropriateness of rate base investment items, allowable expenses and MTS rate structure.

[89] Docket 16258, FCC Staff Exh. 1, p. 4.

[90] Docket 18128, CCB Exh. 11, Attachment A, p. 1.

[91] Docket 18128, CCB Exh. 12, Attachment A, p. 1.

average has further narrowed. Likewise, the MTS level of return under Method 7 has consistently remained below the overall level. Thus, since 1969, at least, MTS has earned a level of return that has been just and reasonable, hence lawful, within the meaning of Section 201(b) of the Act. Nevertheless, these results may have been affected by the necessity to offset residuals for services not recovering their full costs.

187. The return levels indicated for WATS present a different picture. For the year ending September 30, 1975, WATS showed an 11.6% return on investment allocated to it under Method 1 and 16.1% under Method 7.[92] Compared to Bell's 8.5% overall level of return, the WATS rate level, nearly double that of the system, is clearly excessive. (This level of return indicates the presence of cross-subsidization: the high level of return on WATS offsets low levels of return on other services which are earning less than full costs.) It also appears that the WATS return level has been unlawfully high during prior periods under investigation herein. For example, the original Seven-Way Cost Study showed a 13.4% return on investment allocated to WATS for the year ending August 1964, in contrast to 7.5% for the system.[93] In 1967 WATS was earning 11.9% compared to the system-wide average of 7.5%.[94] For 1969 (when Method 7 results first became available) the WATS return level was 10.4% under Method 1 and 18.1% under Method 7 compared to a 7.8% overall return.[95] Similarly, the 1971 results indicated 9.4% and 16.7% respectively under Methods 1 and 7 compared to a 7.8% overall level of return.[96]

188. Despite the foregoing, we do not require any specific actions be taken respecting WATS' return levels at this time, in view of our recent decision in Docket 19989, 59 FCC 2d 671 (1976). In the *WATS* proceeding we concluded, *inter alia*, that the existing WATS tariff was illegal insofar as Bell did not attempt to justify its rates on the basis of costs. Indeed, Bell did not provide any cost support for WATS rates. Instead, Bell attempted to show an "alignment" between WATS rates and those of MTS.[97] As a result of the WATS decision, Bell is to file a new tariff together with rate support cost justification by November 8, 1976.[98] Accordingly it does not appear prudent, in the public interest, to require changes in WATS rate levels at this time.[99]

189. With respect to Bell's other services, (excepting TELPAK which is discussed below) we note that for the year ending September 30, 1975, the return levels measured by Method 1 range from −3.5%

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[92] Bell BSE, Appendix A.
[93] Docket 16258, FCC Staff Exh. 1, p. 4.
[94] Docket 18128, CCB Exh. 11, Attachment A, p. 1.
[95] Docket 18128, CCB Exh. 12, Attachment A, p. 1.
[96] Docket 18128, CCB Exh. 23, p. 5.
[97] The question as to whether Outward WATS and MTS are similar services is also extant and Bell is obligated to justify Outward WATS as a distinct service (59 FCC 2d at 683).
[98] In accordance with Docket No. 19989 the WATS tariff revisions were to be filed on 60 days' notice, to be effective on January 7, 1977. In a September 16, 1976 letter Bell states that this effective date would entail the additional cost of reading customer meters mid-month and abnormal billing for a partial month (7 days). It suggests filing the revisions on 84 days' notice, to be effective February 1, 1977, which would facilitate the normal first of the month meter reading and billing cycle. Because the Bell suggestion would avoid unnecessary cost and disruptions in customer billing cycles, we shall permit the filing schedule as proposed by Bell. We reserve the right, of course, upon consideration of the revisions filed, to take action as may be appropriate including suspension or rejection of such revisions.
[99] We note that it is not clear whether WATS rates should be raised or lowered in order to achieve a proper level of return.

for the Private Line Telegraph Service to 5.5% for Private Line Telephone. Likewise Method 7 results range from −0.6%, also for Private Line Telegraph, to 7.2% for Private Line Telephone.[100] Compared to the overall system level of return, 8.5%, we find the present return levels for Bell's Private Line Telegraph, Private Line Telephone, Audio/Radio, Television, and "Other" service classifications to be deficient since the rates for these services do not cover all relevant costs of furnishing service. This is true whether investment and expenses are allocated to each service according to Method 1 or Method 7. It thus appears that the low levels of return on these services are maintained through cross-subsidization. This we hold unlawful in the absence of express statutory authorization or compelling policy considerations. Accordingly, we conclude that the rate levels associated with these services are unjust and unreasonable, and therefore, unlawful, within the meaning of Section 201(b) of the Act.

190. Past levels of return for these services have generally been unlawfully low, although in some years the level of return for some services could be considered to have approached the zone of reasonableness. In 1971, for example, Television Program Transmission Service (Video) earned 4.9% and 8.3% under Methods 1 and 7, respectively; at the time the overall level of return was 7.8%.[101] Similarly, Video service, as well as Private Line Telegraph and the "Other" service classification, showed adequate earnings levels in 1967 and 1969.[102] The fact still remains, however, that the remaining competitive services, including Private Line Telephone and Audio, did not earn a reasonable level of return on their allocated investment during these same years. More importantly, none of these competitive services are presently priced to earn levels of return that are just and reasonable and, therefore, not unlawfully low. Accordingly, our solution in this proceeding is designed to achieve return levels for these services whereby the earnings for each competitive service can sustain that service's viability without relying on cross-subsidization.

191. In summary, we find that while the application of present FDC Methods 1 and 7 does not constitute the perfect solution for determining the justness and reasonableness of future return levels, the record supports concurrent use of these methodologies as a valuable guide for ascertaining the lawfulness, within a zone of reasonableness, for present and past rate levels, as discussed above. We emphasize that we find that the existence of levels of return that are unjustly and unreasonably high or too low, indicate a return level relationship which embodies cross-subsidization. In the absence of proper justification we hold this cross-subsidization unlawful within the meaning of Section 201(b); it must be eliminated. Moreover, in view of the low levels of return earned on private line services which indicate that they have not been recovering the cost of providing service, we conclude that the loss of these services would not burden MTS. Bell could employ its investment in these services for MTS and earn its authorized return.

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[100] Bell BSE, Appendix A.
[101] Docket 18128, CCB Exh. 23, p. 11.
[102] Docket 18128, CCB Exh. 11, Attachment A, p. 1, CCB Exh. 12, Attachment A, p. 1.

B. Section 202(a) and the Lawfulness of TELPAK

192. It remains to be resolved whether the rate levels for Bell's major interstate categories of service at issue herein are lawful under Section 202(a) of the Act. Consistent with our *Telpak* decision,[103] the RD recognized that competitive necessity may justify what would otherwise be unlawfully discriminatory rates (RD, par. 91). Also, relying on the *Telpak Sharing* proceeding,[104] the RD stated that the Commission has held, with court approval, that discriminatory pricing based on competitive necessity is permissible only if the carrier meets each of the following criteria:

(1) That those benefiting from the discriminatory pricing have an alternative of satisfying their communications requirements from a substitute source of supply and that they will shift to the substitute source unless the discrimination is maintained;
(2) That the discriminatory rate or preference is just sufficient to retain the business which would otherwise be lost;
(3) That the discrimination benefits the users of the carrier's services who are discriminated against, i.e., charges to other users are lower because of the discriminatory rate than they would be without such rates.

The RD states that although TELPAK C and D have been found in compliance with criterion one,[105] it remains to be determined herein whether and to what extent TELPAK C and D bulk rates conform to criteria two and three (RD, par. 92).

193. The RD applies the three above criteria to each of Bell's private line services to determine whether competitive necessity justifies the pricing of each such service at an earnings level less than the fully distributed costs, as measured under Method 1, of each service (RD, par. 187-188). Thus the RD determines that none of the private line services, including private line telephone, audio, video, TELPAK, and private line telegraph, satisfy the first of the three criteria. The RD holds that neither private microwave facilities nor services provided by other communication carriers constitute a sufficient competitive threat to Bell to justify blanket, nationwide discriminatory pricing for any private line service. Additionally, the RD finds that none of the private line services satisfy the second and third of the above enumerated criteria (RD, pars. 189-203). Accordingly, it is concluded, in general, that as a result of the failure to meet the *Telpak Sharing* criteria, Bell's pricing of private line services below an earnings level corresponding to Bell's overall minimum cost of capital is in violation of Section 202(a) of the Act, as well as Section 201(b) (RD, par. 204).

194. With particular reference to Bell's TELPAK bulk offering, the RD states that although the Commission's 1964 holding in the *Telpak* decision found that the TELPAK bulk offering satisfied the first of the three above criteria, serious doubt exists as to whether the Com-

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[103] 38 FCC 370 (1964), 37 FCC 1111 (1964); *aff'd sub nom., American Trucking Association v. FCC*, 377 F.2d 121 (1966) *cert. denied*, 386 U.S. 943 (1967).
[104] 23 FCC 2d 606 (1970); *rev'd on other grounds sub nom., AT&T v. FCC*, 449 F.2d 439 (2nd Cir. 1971).
[105] 38 FCC 370, 395 (1964).

mission's *Telpak* decision is correct under current conditions. Reviewing the competitive threat to Bell's TELPAK offering posed by private microwave systems, Western Union's private line offerings and those of the specialized carriers, the RD holds that these alternative sources of supply for Bell's TELPAK customers are not sufficient to justify the blanket form of discriminatory pricing Bell maintains with respect to nationwide TELPAK service (RD, pars. 197-198). Furthermore, the RD finds that rates for TELPAK have not been set at a level that is *just* sufficient for Bell to retain business that would otherwise be lost in the absence of discriminatory pricing. Therefore, criterion two has not been met. Finally, it is stated that Bell has not shown, to the satisfaction of the third criterion, that the price discrimination maintained with respect to TELPAK has benefited other users of Bell's services in the form of lower rates (RD, par. 199). As a result of the foregoing, the RD concludes that the rate differentials between TELPAK and non-TELPAK services constitute an undue discrimination or preference under Section 202(a) of the Act. (Additionally, the TELPAK tariff, as presently constituted, is found to be unjust and unreasonable within the meaning of Section 201(b)). Therefore, the RD concludes that the TELPAK tariff is unlawful and must be eliminated (RD, pars. 205-206).

195. Several parties have raised objections concerning the RD's discussion of the three criteria and the proper application of them in this proceeding. In general, these objections can be classified into three categories:

(1) those concerning the validity of the three above criteria, in particular the second criterion requiring that the discriminatory rate or preference be just sufficient to retain business which would otherwise be lost, and the Commission's and court's approval thereof; [106]

(2) the RD's application of the three criteria to all private line services to determine whether pricing below the Method 1 FDC level can be justified by competitive necessity even though it is argued that only private line telephone and TELPAK have been found, in the *Telpak* decision, to be "like" services within the purview of Section 202(a); [107]

(3) exceptions concerning the RD's findings that none of Bell's private line services, and in particular the TELPAK offering, has met any of the three criteria. [108]

We turn now to a discussion of these objections:

(1) *The Validity of the Competitive Necessity Criteria*

196. In our Tentative Decision in the *Telpak* investigation, we concluded that TELPAK and other private line services were like services and that while the need to meet competition from private microwave systems might justify the TELPAK C and D classifications, there was

[106] Parties raising this objection include the Airline parties, Bell, DOD, ARINC, the Ad Hoc Committee, and AIA.

[107] Parties excepting to the RD's broad application of the three criteria include the Airline parties, Bell, AIA, and the AP.

[108] The objecting parties here include the Airline parties, Bell, DOD, ARINC, AIA, the Ad Hoc Committee and the Network parties.

insufficient evidence to determine whether the then existing TELPAK rates were compensatory, i.e., whether the rates benefited other users of the carrier's services.[109] It is clear that only two standards were expressed in *Telpak* to justify pricing differentials between like services: (1) an existing need to meet competition and (2) a benefit to other users. These correspond to the first and third criteria enumerated above. In our Final Decision in the *Telpak* proceeding we confirmed the validity of these two tests and we allowed Bell the opportunity to show that the TELPAK rates were compensatory.[110] As explained above, this is now an issue herein.

197. Five years later in the *Telpak Sharing* proceeding, the Recommended Decision of the Chief of the Common Carrier Bureau cited our *Telpak* decision as supporting a three criteria test which is applied in the RD herein.[111] The requirement that the discriminatory rate be just sufficient to retain business which would otherwise be lost was added to the two criteria expressed in *Telpak* to justify discriminatory pricing on an other than cost basis. In our Final Decision in *Telpak Sharing* we approved the three criteria test as being consistent with our holding in the original *Telpak* investigation, case law, and prior orders in the proceeding.[112] More recently, we applied the three criteria test in our Interim Decision in the "Hi-Lo" proceeding.[113]

198. Several parties except to the RD's conclusion that the three criteria test has met with Commission and court approval. Although we do not necessarily find that such approval is lacking, we hold that the application of the second criteria, requiring a showing that the discriminatory rates are just sufficient to retain business which would otherwise be lost, imposes an all but impossible burden on the carrier, at least under present circumstances. Accordingly, we will not apply this criterion in the present case and will reserve judgment on the applicability of the second criterion to other situations. Nevertheless, we hold that the two standards articulated in the original *Telpak* case, namely a showing of competitive necessity and of benefit to other users, control the determination of the lawfulness of TELPAK rates herein.

(2) *The RD's Application of the Three Criteria to All Private Line Services*

199. As indicated, the RD applied the three criteria to all private line services to determine whether there is justification to price below an FDC Method 1 level. We believe, for the reasons discussed below, that these standards should apply only to a service which is found to be "like" another service and which is offered at a price differential purportedly to meet competition. This is consistent with our decision in the original *Telpak* proceeding.[114] Where charges for services are at

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[109] 38 FCC 370, 377, 395 (1964).

[110] 37 FCC 1111, 1118 (1964), *aff'd sub nom., American Trucking Ass'n. v. FCC*, 377 F.2d 121 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967).

[111] 23 FCC 2d 639, 648 (1969).

[112] 23 FCC 2d 606, 613 (1970), rev'd on other grounds sub nom., *AT&T v. FCC*, 449 F.2d 439 (2nd Cir. 1971).

[113] 55 FCC 2d 224, 242 (1975).

[114] 38 FCC 370 (1964), 37 FCC 1111 (1964), *aff'd sub nom., American Trucking Ass'n. v. FCC*, 377 F. 2d 121 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967).

issue, Section 202(a) proscribes only unjust or unreasonable discriminations, involving substantially similar services. *Cf., Atchison, T. & S.F. Ry. Co.* v. *U.S.*, 218 F. Supp. 359 (1963).

200. Before continuing, we make certain observations. First, we do not wish to imply that only services found to be "like" can be priced to meet competition. Consistent with our decision herein, rates for any private line service can be established that would place the carrier in an appropriate competitive position. We reiterate that it is our objective to provide the carrier with pricing flexibility within a framework of accountability and full and fair competition. In investigating the lawfulness of a rate differential between two or more services, it is only when the services are found to be "like," that the differential must be justified under Section 202(a) of the Act. Second, it is not entirely clear, as some parties contend, that TELPAK and other private line services have generally encompassed only voice-grade channels. TELPAK C and D might be considered to be like other services offered by Bell. *American Trucking Ass'n.* v. *FCC*, 337 F.2d 121, 131-132 (1966). In fact, we found in our Tentative Decision in the *Telpak* case that ". . . *various private line services*, on the one hand, and the TELPAK 'derived channels,' on the other, are like communications services" (emphasis supplied).[115] Finally, we emphasize that our decision herein does not imply that violation of Section 202(a) can never occur except with respect to differing charges for like services. Various other arbitrary and unreasonable actions and classifications on the part of carriers which do not necessarily involve rate level discrimination with respect to like services fall within the prescription of Section 202(a). *See e.g., Chastain* v. *AT&T*, 43 FCC 2d 1079 (1973); "*Hi-Lo*" Decision, 58 FCC 2d 362 (1976).

201. In this proceeding, however, we *are* concerned with price level differentials between like communications services. We find that the two competitive necessity criteria we have heretofore found pertinent, should be applied only to Bell's TELPAK-offering to determine violation of Section 202(a). Although other private line services face varying degrees of competition and although some or all of these other services can be considered "like" TELPAK service, it was in fact Bell's introduction of TELPAK which initially gave rise to the discrimination, and it is the continuation of TELPAK which perpetuates it. Accordingly, we believe that Section 202(a) does not require application of the competitive necessity test to all private line services.[116] We hold that a discrimination is not unjust nor unreasonable if the like service which is priced to meet competition can satisfy the competitive necessity test, or is otherwise justified with relation to the cost of providing service, or on the basis of other policy considerations.

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[115] 38 FCC 370, 378-379 (1965).

[116] We recognize that apart from the problem of rate differentials for like services, it could be argued that Section 202(a) would be violated if Bell used LRIC to price its private line services only and not MTS or WATS. In essence, a class of customers, i.e., of private line service, would receive an advantage denied another class of customers, i.e., the MTS and WATS users. However, in light of our findings herein, with respect to the justness and reasonableness of the various costing methodologies, we do not find it necessary to decide whether such advantage would be undue or unreasonable under Section 202(a). Additionally, we found herein cross-subsidization existing between WATS and the non-TELPAK competitive services. As the RD recognized, in the absence of express Congressional approval such cross-subsidization can constitute undue or unreasonable preference or disadvantage within the meaning of Section 202(a) (RD pars. 176, 186). Inasmuch as we have found the rate levels giving use to such discrimination unlawful under Section 201(b), we need not address whether a 202(a) violation is justified by competitive necessity or otherwise.

(3) *The RD Findings That Bell's Private Line Services Do Not Meet The Competitive Necessity Criteria*

(a) The Need to Meet Competition:

202. We indicated above that to justify a discrimination under Section 202(a), the competitive necessity test is to be applied only to Bell's TELPAK offering and that this test, under the circumstances herein, consists of two criteria: whether there is a need to meet competition and whether the established rates benefit other users. Our task here is to decide whether the pricing differentials between TELPAK and like services are justified by the need to prevent TELPAK users from shifting to substitute sources of supply. Additionally, it remains to be determined whether the rate level discrimination between TELPAK and like private line services benefits users of Bell's other services.

203. The RD questioned the applicability of our holding in the *Telpak* decision that Bell has met the first competitive necessity criterion in light of the current competitive marketplace. The RD concluded that bulk TELPAK service, to the extent it is differentiated from broadband service, lacks sufficient comparability to private microwave service to find private microwave a competitive substitute for TELPAK (RD, par. 197). Additionally, the RD stated that specialized carriers do not pose a sufficient competitive threat to Bell to justify nationwide discriminatory TELPAK pricing. The RD based its conclusion on the fact that specialized carriers are presently excluded from the Bell-Western Union agreement which enables a customer to obtain nationwide TELPAK service from either Bell or Western Union, and obtain a rate as if only one carrier provided all the service. Furthermore, in the opinion of the RD, the specialized carriers cover such a limited geographical area that they cannot be considered a serious threat to nationwide TELPAK service (RD, par. 198).

204. We are in substantial agreement with the RD's conclusions. There are significant differences between TELPAK and private microwave which precludes a finding that on a nationwide basis private microwave is a viable alternative to TELPAK. Private microwave construction requires a substantial capital investment with long-term resource commitment which is not necessary when a customer orders TELPAK service. Thus, private microwave service cannot be easily terminated or readily extended like TELPAK. Once private microwave facilities are in place, the bulk communications users incur substantial fixed costs, whether the facilities are utilized or not. Finally, although interconnection of private systems with carrier systems has been liberalized, certain restrictions remain on such interconnection. It thus appears that the permanent, more restricted nature of private microwave facilities constitutes an important consideration influencing the viability of TELPAK vis-a-vis private microwave, even assuming the latter may be cost competitive over given routes.

205. In our *Telpak Sharing* decision we found that despite testimony from shared TELPAK users as to their intentions to consider private microwave if TELPAK sharing provisions were eliminated, the evidence therein suggested that nonsharing factors, such as user control, cost, greater flexibility, and the existence of rights-of-way, possibly played a determinative role in the user's choice of whether to employ private microwave. We therefore found that it was not shown that shared private microwave offered a competitive alternative for

certain user groups.[117] We find that the instant proceeding presents analogous circumstances. Consequently, we are unable to find that the TELPAK offering as presently structured, constitutes a proper response to the extent of competition posed by private microwave. We nevertheless believe that a properly structured bulk rate offering, which would compete with private microwave or other alternatives along the routes where such competition exists and along the quality dimensions that make such other alternatives competitive, is justified. However, it is clear from the record herein, that the *nationwide* rate differential existing between TELPAK and like private line service cannot be supported by alleged cost comparability between TELPAK and hypothetical private microwave systems.

206. Further, we question the validity of the cost studies and statements made on the record herein that private microwave is cost effective when compared to TELPAK. First, the cost studies are of questionable vintage and necessarily do not account for recent increases in building materials, construction and land costs. Second, we do not find persuasive the self-serving statements of TELPAK users that they would abandon Bell if the rates they paid were increased. Despite the alleged cost effectiveness of private microwave and continuing increases in TELPAK rates, such a wide scale shift has not occurred. This strengthens our conclusion that non-cost factors play a significant role in a customer's decision to leave Bell in favor of constructing their own private microwave systems.

207. Finally, we agree that the specialized carriers do not present a sufficient competitive threat along their few routes to justify nationwide discriminatory pricing on the basis of competitive necessity. While growth in specialized carriers and satellites might justify such a competitive response in the future, this uncertain probability is not sufficient to justify the present TELPAK offering. Bell's witness, Charles Miller, stated herein that TELPAK rates are designed "to be competitive with future situations." (T. 842.) Such future contingencies are not enough to justify such a broad competitive response whether the alternative to TELPAK under consideration is private microwave, specialized carrier or satellite. On appeal of our *Telpak Sharing* proceeding, the court rejected AT&T's contention that a mere probability of a shift to a substitute source justifies the discriminatory provision. The court held that such a criterion "is far too vague in relation to § 202(a) of the Act." *AT&T* v. *FCC*, 449 F.2d 439, 449-450 (2nd Cir. 1971). The court approved the Commission's standard requiring "a showing that those eligible to share Telpak *would* in fact shift to private microwave if the existing discrimination were not maintained" (emphasis in original), 449 F.2d at 449. Clearly, the evidence herein cannot support a finding that present TELPAK users would in fact shift to private microwave if the existing rate discrimination were not maintained. That such a shift would occur under the facts shown herein is nothing more than conjecture. Even if such a shift were to occur it could never justify the blanket nationwide discrimination inherent in the TELPAK rates. Accordingly, we conclude that under

[117] 23 FCC 2d 606, 618-620.

current circumstances the TELPAK discrimination is not justified by competitive necessity.

208. In sum the rate level differential existing between TELPAK and other private line services constitutes an unlawful discrimination between like services under Section 202(a). We do recognize, however, the benefit to industrial, transportation and government users from a bulk communications offering. Accordingly, we are ordering Bell to eliminate its present bulk offering. Bell may file within the eight month period outlined below a new appropriately responsive bulk offering consistent with our guidelines herein, which can be supported on the basis of competitive necessity, costs, or other relevant factors.

(b) Compensativeness and Section 201(b)

209. We have found the discrimination existing with respect to TELPAK and like private line services unlawful since TELPAK as presently constituted is not justified by competitive necessity. Accordingly, we need not decide whether the TELPAK rates are compensatory or whether they are lawful within the meaning of Section 201(b) of the Act. We note that TELPAK for the twelve months ending September 30, 1975 allegedly earned 8.4% under Method 1 and 12.6% under Method 7.[118] Compared to the overall company return of 8.5%, these earnings appear to be within the zone of reasonableness. However, we question whether TELPAK's return level can be substantially higher than that of private line services since TELPAK has the same cost characteristics as such services and TELPAK rates are lower. We recognize that demand factors might explain this discrepancy insofar as we have found that TELPAK attracts customers who may not have substitute sources of supply. For such customers, TELPAK is not justified by competitive necessity. Thus, TELPAK's earnings level, as contrasted with that of other private line services, may result from an artificial and unwarranted service category structure.

C. Prescription

210. In light of the foregoing findings, the remaining issue is whether the Commission should prescribe rate levels for various service classifications pursuant to Section 205. For the reasons discussed above we believe it necessary to prescribe guidelines to govern the filing of future tariffs, rather than prescribe specific rate levels. We also require adjustment of rate levels and rate level relationships so as to eliminate the infirmities we have found.

211. Under the RD, Bell is ordered to file new rates designed to achieve return levels for its private line services equal to Bell's minimum overall cost of capital, on investment allocated under fully distributed cost Method 1. Similarly, the RD required Bell to make revisions in its MTS and WATS rates so the earnings level for each of these services would be no more than the maximum overall return permitted by the Commission, under Method 1 (RD, pars. 211, 227).

212. Section 205(a) of the Communications Act gives us authority to prescribe charges, classifications, regulations, and practices of communications common carriers.[119] Any such prescription can only be made

[118] Bell BSE, Appendix A.
[119] 47 U.S.C. § 205(a) (1970).

after full opportunity for hearing and upon a finding that the action taken is just and reasonable as supported by evidence of record.[120] Several parties, in particular the Airlines and the Network parties, argue that the RD's recommendation of fully distributed cost Method 1 as the appropriate and sole standard for establishing rate levels for Bell's interstate categories of service, is a prescription which violates the above standards and is therefore unlawful. It is claimed that there is insubstantial evidence to make the findings of justness and reasonableness required for a Section 205(a) prescription. It is further argued that there has not been a "full opportunity for hearing" on the various FDC methodologies. Thus, the parties state that FDC Method 1 cannot be the basis for determining the lawfulness of future rate levels.

213. Insofar as we are not relying on FDC Method 1, we do not find it necessary to discuss the parties' arguments as they apply to the recommended order. However, we believe that the questions they raise are relevant to the validity of the guidelines we adopt.

214. The Network parties rely extensively on *Nader* v. *FCC*, 520 F.2d 182 (D.C. Cir. 1975), to show that the adoption of FDC Method 1 for ratemaking purposes would be a prescription under Section 205(a) of the Act. *Nader* was an appeal from our Decision in Phase I of Docket No. 19129 establishing an 8.5% overall rate of return for Bell and subsequent orders accepting Bell's rate increases designed to achieve that rate of return.[121] On appeal, MCI argued that such action constituted an unlawful prescription within the meaning of Section 205(a).[122] Summarizing, the court held that the Commission's order, limiting prospectively Bell's rate of return to 8.5%, was a prescription under Section 205.[123] The court concluded that although Section 205 does not expressly authorize the Commission to prescribe rates of return, as opposed to individual rates, such authority is encompassed within the broad grant of regulatory power under Section 4(i) of the Act, 47 U.S.C. § 154(i) (1970).[124]

215. We would agree with the conclusion that our guidelines herein amount to a prescription. However, it is clear that the parties to this proceeding had ample notice that the Commission's prescription of a particular costing methodology was at issue herein. While we have phrased the prescription issue in terms of specific rate levels, there can be no doubt that the same embraces the prescription of a particular costing methodology.[125] It is evident that the parties have held a similar view. Several parties have proposed, during the hearing stage and in exception to the RD, various methodologies to be adopted by the Commission as alternatives to LRIC and FDC Method 1.[126] Furthermore, we read *Nader* to show that the prescription of our guidelines is valid pursuant to the authority vested in us by Sections 4(i) and 205(a) of the Act.[127]

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[120] *See Nader* v. *FCC*, 520 F.2d 182 (D.C. Cir. 1975); *AT&T* v. *FCC*, 487 F.2d 864 (2nd Cir. 1973); *AT&T* v. *FCC*, 449 F.2d 439 (D.C. Cir. 1971).

[121] 38 FCC 2d 213 (1972); 38 FCC 2d 492 (1972); 38 FCC 2d 984 (1973); 42 FCC 2d 293 (1973).

[122] 520 F.2d at 199-200.

[123] *Id.* at 201.

[124] 520 F.2d at 204.

[125] See Section III, *supra*, and 21 FCC 2d 495 (1970).

[126] These proposals include the Airline Parties' "Accommodation Theory"; Bell's recommendations in its Brief in Support of Exceptions, pp. 47-57; and DOD's Long Run Average Cost Technique.

[127] 520 F.2d at 203-204.

216. Finally, the parties have had a full opportunity to be heard including oral argument, and the action taken is just and reasonable as supported by the record. Our guidelines are predicated on FDC Method 7, modified to accommodate statutory needs and objectives, which we previously indicated emanate from our legislative mandate and prior decisions. As noted, these objectives have been recognized and discussed, in substantial part, by the parties to this proceeding. The parties had ample opportunity in this lengthy record to present their views on these matters. Thus, there is substantial support for the finding that these objectives constitute just and reasonable criteria which may be incorporated into our proposed costing methodology. [128]

217. The relative merits of FDC Method 7 have also been explored extensively herein. For example, several parties support FDC Method 7, or the historical cost allocation procedures embodied therein, as part of alternatives to Bell's LRIC methodology. [129] The Network parties advocated Method 7 as the most rational of the full cost approaches. [130] Even Bell extols the virtues of FDC Method 7 vis-a-vis Method 1. [131] In particular, Bell states:

> Method 7 has a lot of merit because it faces up to the problem of directly attributable costs and unallocable common costs, and it gives you a means of tracking, and that it gives you another test for the compensativeness of rate levels. [132]

The Department of Defense urges us to adopt FDC Method 7 if we decide that a full-cost standard is appropriate. [133] Finally, the concept behind FDC Method 7 is inherent in Bell's "retrospective accountability" analysis. [134] Thus, it is clear that the parties have had adequate opportunity to air their views on historical cost causation and to test the view of others within a hearing framework. Likewise, there is substantial evidence to support our finding that historical causation is a just and reasonable method for allocating costs to the various categories of Bell's interstate services.

218. In conclusion, our guidelines are lawful as a prescription within the meaning of Section 205(a) of the Act. The parties have had an opportunity to be heard with respect to the concepts embodied within our guidelines and the record supports our findings that such concepts are just and reasonable.

XIII. GUIDELINES FOR A "PROPER METHODOLOGY"

A. General

219. We have previously discussed the methodologies of record and their appropriateness for determining the lawfulness of rate levels and relationships vis-a-vis applicable objectives and responsibilities. For such determinations, we have concluded that only a methodology designed to cover the full recorded costs of operations constitutes a proper standard. Nevertheless, we have found merit in marginal cost-

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[128] See discussion, *supra*, and the record cites at Section VIII.

[129] Bell Brief in Support of Exceptions, pp. 53, 56. Historical causation also lies at the heart of the Airlines' "Accommodation Theory," Airline parties OSE, pp. 46-52; T. 15708-15711; Airline Rebuttal Exh. 1.

[130] T. 15730.

[131] T. 15621-29. *See also* T. 9655, 9738-39.

[132] T. 15628-29.

[133] DOD BSE, p. 13.

[134] *See* Bell Exhs. 18, 25.

ing and we will consider such full cost departures under guidelines specified herein. Otherwise, we have found Bell's use of disparate and incongruous ratemaking concepts among its various services to be unlawful under the provisions of Sections 201 through 205 of the Act. We have found that Bell's "basic service philosophy" of ratemaking constitutes an unlawful ratemaking concept. As discussed earlier, this or any other philosophy that results in disproportionate cost burdens among services would generally violate our objectives and responsibilities.

220. A corollary to our ruling on the use of disparate ratemaking concepts concerns the breadth of supportive materials required for tariff filings. We hold that revisions to any existing service rate level or rate relationship to other service's rates must be supported by a showing of the *overall* impact of such revisions. This showing is to include proper estimates of cost function changes and cross-elasticity data, the subsequent rate structure, and the rate base and revenue requirements (and changes in these factors) for each of the various Bell services. Data must herein be presented in a manner consistent with our guidelines concerning such matters as the proper ratemaking methodology and distribution of facilities among services. Recognition of the overall impact of such changes is consistent with our requirements below concerning establishment and updating of an assignment of all facilities, and use of a full recorded costs, historical causation basis of ratemaking.

221. For rates filed subsequent to this proceeding, we find that even with revisions to Methods 1 and 7, and our primary reliance on Method 7 procedures, we will nevertheless require an array of cost, demand and other information to make a determination of lawfulness. We find that Method 7 (employing revised procedures) will adequately mirror cost causation responsibility, while Method 1 (likewise employing revised procedures) will indicate the pattern of current demand and usage. We have also included below provision for the incorporation of prospective data into our evaluative processes. This information, taken together with public interest considerations and the relevant objectives and responsibilities, will encompass the basis of our decision making.

222. In the interest of providing a perspective for the specific guidelines discussed below, we have determined certain appropriate attributes of an overall ratemaking methodology. Heretofore, we have discussed the need for each service to cover its full recorded costs. Additionally, we discussed the attractiveness of determining these costs on historical causation basis (properly updated) in regard to the avoidance of cross-subsidization and for the provision of the foundation of a program of continuing surveillance. Inextricably interwoven with the cross-subsidization, cost allocation, and ratemaking issues, however, is the substantial magnitude of Bell's facilities and facility related costs. Indeed, determination of plant responsibility impacts directly on realization of Commission objectives and responsibilities. It is for this reason that our first guideline provides for the assignment of all existing facilities to Bell's various services. Additionally, we have indicated how new facilities and retirements should be treated in conjunction with the development of an initial assignment of facilities or "datum." It is shown that the datum can be adjusted to reflect evolving demand

patterns and other considerations. We find that the development of a datum will allow the fulfillment of such basic considerations as accountability and clarification of market rules.

223. Other guidelines deal with permissible departures from rates determined on a full recorded costs, historical causation basis. We recognize that carrier pricing flexibility may be warranted in situations where less-than-full cost based rates will permit beneficial cost efficiencies and demand adjustments over time. Clearly, the Bell System respondents (if only for competitive services) and other parties support certain full cost departures (the offering of "discount" rates) (Bell, P.F., pp. 27-55), albeit they do not ostensibly consider such discounted rates as being derived from a full recorded costs standard.[135] The RD also considers discount rates to be plausible under certain circumstances, but holds that FDC methods should constitute the *basic* underlying support of primary (undiscounted) prices (see RD, pars. 162-164). We will thus entertain requests for waivers in connection with particular tariff filings which would permit full cost departures for a "reasonable time certain," provided that the carrier can make a clear and definitive showing of benefits to be realized by the body of Bell service users, and that such departures are consistent with the public interest (e.g., the objectives and responsibilities discussed in Section VIII). We further require that within such a reasonable time certain, the rates charged users benefiting from such discounts will be required to cover all recorded costs, including residuals.

224. Finally, we have delineated below guidelines concerning acceptable forecasting techniques, needed technical revisions to Method 1 and Method 7, and the future use of these methods in our evaluative processes. We have directed the carrier to incorporate our guidelines into its rates and rate relationships through the timely filing of revised tariffs. On balance, the guidelines themselves, our objectives and responsibilities, and the discussion and findings above constitute the scope of our decisional process. This process has deliberately not been defined in an all-encompassing, exacting and mechanical fashion. It is definitive, however, with respect to *minimum* materials required to support rate levels and departures from datum-based, full costs. Further, carriers may seek a waiver and support same with such additional materials as they consider proper. We recognize the dynamic, evolutionary nature of telecommunications, and do not wish to foreclose unforeseen developments by constructing overly rigid requirements.

B. Plant Assignment

225. An assignment of existing facilities and plant under construction is consistent with our intended use of a historical causation, FDC methodology as our primary means of determining the justness and reasonableness of rate levels and relationships. In the interest of fair competition, it is also necessary for existing and potential competitors of Bell to be able to estimate Bell's facility costs in order to gauge their own cost effectiveness and market incentives. As long as Bell can construct many plausible facility assignments in response to competi-

[135] See Section IX.

tion, an individual service's costs will remain essentially "fluid" (i.e., open to management discretion) and unclarified. Under such circumstances, it is likely that the benefits of competition for all users, Bell, and entrant firms will be at least partially unrealized. Most importantly, the Commission itself, of course, cannot hope to achieve its accountability objective under conditions of "fluid facility assignment."

226. Firm facility assignments are also necessary to assure equity among users. A basic outgrowth of this objective is the idea that all customers of the firm should share in both the benefits and detriments that accrue from the firm's established market position. More than the other objectives, however, equity implies *proportionate* facility assignments. For example, where economies of scale exist, it cannot be determined that one customer group or another is responsible for such economies. It is the entirety of the customers which sustains the necessary level of output yielding increasing returns to scale when such returns, in fact, exist. In fairness, all customers should derive proportional benefits in such a situation. Such a philosophy extends to advantages the firm may offer such as an established and effective research and development program, management expertise, technological innovations, personnel training programs, ownership of strategically located properties, goodwill, an ongoing and positive relationship with the financial community, long standing and advantageous contractual agreements, accumulated knowledge and other such aspects of the firm's operations. Likewise, as we have previously noted, an existing firm's operation may also involve less attractive features. For example, if inertia, outmoded technologies, bureaucratic inefficiencies or ineffective management and poor past investment decisions impair operations, all customers must also share such disadvantages. This concept is especially critical to the assignment of the costs of facilities to the various services. As noted above, the loading of the costs of older (generally less efficient) facilities onto monopoly services through the use of disparate pricing methodologies is unreasonable. In accepting the concept of historical causation, we must assure ourselves that the practices used in the actual cost allocation procedure allow fulfillment of our mandate under the Act to ensure just, reasonable and nondiscriminatory rates.

227. The method to be used for the allocation of facilities costs, to the maximum extent possible, must be one of assigning such facilities on the basis of historical causation to all services. Of course, the carrier must provide evidence of causation for facilities currently in place that goes beyond mere initial usage. Projected usage is important here. This initial assignment will establish shares of directly attributable plant. Common plant will then be assigned to the pertinent services *pro rata* according to each service's share of the total directly attributed plant. (For the purposes of these guidelines "pertinent services" simply refers to a group of two or more services which may use a particular facility.) This process will constitute a "datum" which will provide the basis for future actions. As explained below, it is contemplated that Bell will undertake a diligent and thorough historical analysis of its interstate plant with the objective of matching facility cost assignments as closely as possible to the uses for which such facilities

were placed.[136] As new facilities are completed, those portions which are directly attributable shall be assigned to the respective services. Newly completed common facilities shall be assigned to the pertinent service categories on the basis of the projected circuit use accounted for by each service. We believe that such a procedure most closely parallels the concept of historic cost causation.

228. Retirements of facilities and the removal of their associated costs from the "datum" plant shares shall, as closely as possible, correspond to the assignment of such facilities to the various services. Those facility retirements which cannot be directly associated with individual services shall be handled as common, and retired from all pertinent services based on each service's "datum" share (i.e., the portion of total plant allocated to each service).

229. The Commission recognizes that conditions may change and that modifications in the shares of plant may be necessary. Market demand shifts, restructuring or modification of existing services, the introduction of new services or the elimination of existing services are examples of such changes. We do not seek a system so rigid that the carrier's ability to adapt to such changes is unduly impaired. In line with this objective, reassignments of facilities will be approved upon a proper showing. The Commission itself will periodically compare Method 1—relative use based assignments of plant—to historical causation assignments for evidence of gross imbalances. However, carriers and other parties may submit other evidence, such as actual use, in support of proposed assignment revisions. Thus, in the final analysis, the Commission will determine the validity of plant assignments after each periodic evaluation.[137]

230. In establishing the initial allocation based on cost causation, it is suggested that the carrier consider beginning with the 1964 Seven-Way Cost Study assignments and then work forward to the current time. This would avoid the problem of constructing data series for older vintages of plant which find somewhat limited use in the rendition of services today. The effects of any infirmities that may have existed in that study would be minimized due to the large growth of plant since that time. Concomitantly, it would account for most of the telephone plant in service today, due to the fact that plant in service now is over three times that in service at the time of the Seven-Way Cost Study, and that substantial retirements of pre-1964 plant have occurred in the intervening periods. Further, such an approach would aid in the development of exact procedures for the handling of a discontinued service (such as the sale of TWX). We expect full documentation of the assignment study and rationalization of the selection of the starting point if it is any other than that suggested herein.

231. In general, the Commission views the use of this approach as a dynamic, continuous process. The establishment of the current, updated book cost "datum" described above should facilitate and expedite proceedings before us. The datum's periodic updating will aid in our

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[136] Specific facilities are actually to be assigned to specific services, to this extent, paralleling the Seven-Way Cost Study procedures.

[137] The actual period to be employed for reevaluation of plant assignments will be determined by the Chief of the Common Carrier Bureau.

continuing surveillance and go far toward meeting our objective of accountability. We expect that sh wings in support of changes of the allocation to be supported by material as required under Sections 1.363 and 61.38 of our Rules. Such showing should include rate effects on the service in question as well as any effects on related service offerings. To the fullest extent possible, the disposition of both fungible and non-fungible plant must be demonstrated, particularly in the case of a discontinued service.

C. Departures From Full Recorded Costs

232. We have recognized that there are instances in which historical data may not form the complete basis for projections of future costs or demand. Indeed, it may be appropriate to depart from rates based on historical costs under exceptional circumstances in order to reach certain operating efficiencies or demand levels at which economies of operations may be realized. When a firm has achieved these more efficient conditions, historical trends might again serve as the basic supportive data for a service's rates. Under our guideline ratemaking methodology, the carrier would submit a historic cost causation based FDC analysis for tariff justification. This analysis would be complemented by relative use FDC information for comparative purposes. Despite the projected elements involved in the causational analysis and the fact that it is to be complemented by current relative use data, we recognize that required supportive materials retain an intrinsic "weighting" caused by embedded facilities. For this reason, we may find it reasonable to grant waivers to afford the carrier the flexibility to alter current rates based on forecasts of demand and costs as embodied in a forward looking, cost causation based analysis. This will be permitted provided that the carrier can make a clear and definitive showing that all shortfalls in meeting revenue requirements based on historical full recorded costs will be made up within a reasonable time certain, and that the departure will benefit the body of Bell's users. This requirement should not prove burdensome if the carrier will, in fact, realize the economies projected. As part of the showing, we expect the carrier to develop techniques which employ our guidelines in a prospective manner, with refined forecasting methodologies.

D. Other Guidelines

233. The Bell System has employed certain forecast data in developing its LRIC rates for private line services. We have discussed the infirmities of its forecasting techniques and methodology within the context of theoretical marginal costing. Bell, as noted herein, maintains that it makes no use of projected analyses in constructing its historical causation (Method 7) individual service costs. We find that projected uses of plant should be a part of the logic of historical cost causation. Therefore, Bell should incorporate such data into these analyses for our review. However, since we have no evidence in the record concerning proper forecasting techniques, we direct Bell to develop proper techniques in conjunction with the Common Carrier Bureau staff. In any event, we place Bell on notice that although the datum will partially contain prospective cost causation estimates, any variance from

such projections will ultimately have to be reconciled, including the recovery of deviations in forecast accuracy.

234. Our primary FDC Methodology for the determination of the justness and reasonableness of rate levels and the rate relationships will be based on the logic of historical cost causation. However, in our FDC Methods discussion above (Section XI), we find that Bell's Method 7 procedures do not faithfully adhere to the principles of historical causation. We therefore direct the Bureau staff (in consultation with the carriers) to correct such infirmities in Method 7 as we have discussed above. These deal with such problems as Method 7's failure to incorporate projected uses of plant into its allocative process, its incorporation of management "dedications" of common plant to certain services into its plant assignment procedures, and its ability to be manipulated by unwarranted reassignments of previously distributed facilities. Similarly, we direct that Method 1 be revised in accordance with our earlier discussion so that it too can be incorporated into our evaluative processes. Method 1 would be used in conjunction with a Method 7 analysis to indicate the results of a distribution of costs on a relative use basis. In particular, such results might indicate the need for a reassignment of plant to reflect varying growth rates of Bell's services and other demand factors.

235. We direct that the revision of Method 1 and Method 7 procedures be completed in accordance with our findings and conclusions herein, and reported to the Commission within three months from the effective date of this Decision. Furthermore, we require Bell to file rates based on the reconstructed Method 7 analysis (supplemented by revised Method 1 data) for *all* of its services within eight months of this Decision. Additionally, we will require like analysis to be submitted upon the filing of later tariff revisions in a manner which will disclose the effects of such revisions on the rates of *all* services. We also require these analyses to be submitted within a year after the completion of major construction programs and at such other times as we deem appropriate.

XIV. EXCEPTIONS TO RECOMMENDED DECISION

236. We have stated herein the bases for our decision and the extent to which we are in agreement or find it necessary to modify or elaborate on the findings and conclusions of the Recommended Decision. To the extent that the exceptions to the RD are in accord with our findings and conclusions herein, they are granted; otherwise they are denied. We shall issue in the near future a supplement to this document in which we shall dispose of each of the individual 1000 or more filed exceptions. In arriving at our decision we have given consideration to the exceptions, briefs in support thereof and argument made thereon. However, because of the large number of exceptions submitted, we deem it important that the exceptions comply with Section 1.277(a) of our Rules and Regulations. In particular, in ruling on individual exceptions we will not hesitate to reject exceptions which contain argumentative matters and lengthy discussions of law, which do not provide reference to the record upon which the exception is based, or which do not otherwise comply with Section 1.277(a).

XV. CONCLUSIONS

237. Our conclusions herein are pursuant to Sections 1, 4, 201-205, 210, 214, and 396 of the Act: The ascertainment of what constitutes the actual cost of providing a category or subcategory of service is essential to the performance of our regulatory functions. More specifically, in order to determine whether rate levels and rate level relationships are just, reasonable or not unduly discriminatory the actual full costs of providing service must be known and certain, irrespective of whether rates are in direct relationship to costs or depart therefrom. In the latter case the ascertainment of actual full costs still provides the relevant standard to aid in the determination of lawfulness of rates. (In the absence of such knowledge the Commission is unable to identify with certainty the presence of interservice cross-subsidization.) The major concern of the Commission in this proceeding as to past, present and future rate levels is to find the most appropriate basis or methodology to measure the costs actually and equitably attributable to providing service.

238. For the past and present rate levels and relationships at issue in this proceeding we employ a zone of reasonableness defined by FDC Methods 1 and 7[138] to indicate lawfulness. On the record before us we hold these methods acceptable. However, future rate levels and relationships are to be established in accordance with the guidelines established herein as set forth in Section XIII, *supra*. Rates filed in accordance with such guidelines will best fulfill our statutory mandate. Method 7 costs will form the primary basis for justification of all tariff filings, in conjunction with Method 1 data which will provide us with a comparative benchmark of present relative use. Upon a proper showing, as described previously, we will consider waivers to depart from the prescribed methodology.

239. With regard to the carriers' past and present rate levels and rate relationships our conclusions are in accordance with that stated in Section XII.

XVI. ORDER

240. Accordingly, in view of our findings and conclusions herein and pursuant to Sections 4, 201-205 and 403 of the Act, IT IS ORDERED, That revised rate levels for the major categories of interstate service at issue herein shall be filed within eight (8) months from the effective date hereof and in accordance with costing guidelines and methodologies specified in Section XIII, *supra*.

241. IT IS FURTHER ORDERED, That, in accordance with Section XIII hereof, Bell and Western Union shall consult with the staff of the Common Carrier Bureau to revise FDC Methods 1 and 7 procedures and forecasting techniques, the results of same to be reported to the Commission within three (3) months from the effective date hereof;

242. IT IS FURTHER ORDERED, That, within eight (8) months from the effective date hereof, Bell shall terminate its existing TEL-

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[138] We conclude that the LRIC and marginal costing methodologies of record are inadequate to allow us to perform our statutory functions for the reasons set forth in Sections IX-XI.

PAY offering, but may file a replacement bulk offering consistent with our findings and guidelines herein.

243. IT IS FURTHER ORDERED, That all extant accounting orders herein are hereby TERMINATED; and

244. IT IS FURTHER ORDERED, That these proceedings are TERMINATED.

FEDERAL COMMUNICATIONS COMMISSION,
VINCENT J. MULLINS, *Secretary.*

ADDITIONAL VIEWS OF CHAIRMAN RICHARD E. WILEY

In Docket 18128

I regret that this public comment on Commissioner Hooks' dissenting opinion is necessary. However, statements, characterizations, and conclusions set forth throughout that document do not reflect either the record evidence in this proceeding, or the import of the Commission's decision. Time does not permit me to address each departure from the facts and sound reasoning. Nonetheless, several salient points need be made so that the public is not misinformed:

1. The rates for interstate private line services, used solely by businesses and government, historically have been priced below their full costs while basic telephone rates have been set at or above full costs to make up the difference. In fact, the 1964 Seven Way Cost Study performed by AT&T led to the initiation of this proceeding precisely because it appeared that telephone ratepayers were subsidizing interstate private line users.

2. Docket 18128 is not a referendum on competition in the private line field. Indeed, since Docket 18128 predated the Specialized Common Carrier decision by seven years, it is apparent that the basic issue here is not competition but whether the telephone ratepayers should be forced to continue subsidizing private line users. The formulation of sound cost allocation methods and restrictions on rate levels were necessary because AT&T is a company offering a multiplicity of services which have common costs. Without identifying the proper costs of each service, the public is left exposed to pricing decisions that may result in one class of users subsidizing another. This would be true even in the absence of competition.

3. Once the costs of each of AT&T's services are identified, regulatory agencies, the Congress, and the American people will be able to make fundamental decisions concerning the desirability of subsidies between classes of users. These decisions can then reflect conscious social and political judgments made with the full knowledge of all consumers.

4. Under the incremental methodology which Commissioner Hooks cites so approvingly, AT&T would be free to subsidize private line service offerings at the expense of the telephone ratepayer. Interestingly enough, AT&T has not proposed that such incremental pricing be applied to interstate telephone service, but only selectively to its private line services. This, of course, marks a significant departure from the various authorities quoted by Commissioner Hooks in support of that methodology.

5. Under Fully Distributed Cost Method #7, the Commission has afforded the carrier the opportunity to realize efficiencies and economies attributable to common plant while retaining the elements of accountability needed to safeguard the public telephone ratepayer.

In view of the common concern for basic telephone subscribers shared by Commissioner Hooks, myself, and my colleagues in the majority, I am at a loss to understand the basis or rationale for the dissent. It ignores the stark reality that public telephone users have not been beneficiaries of subsidies from private line services but, more likely, have been burdened by them. In my opinion, the dissent rejects sound measures needed to ensure telephone company accountability on behalf of the telephone subscriber in favor of telephone industry proposals which afford no such public safeguards. With all due respect, the actions endorsed by Commissioner Hooks would do considerable disservice to the very class of users he desires to protect.

DISSENTING STATEMENT OF COMMISSIONER BENJAMIN L. HOOKS

In re: *American Telephone and Telegraph Company*
Long Lines Department
(Docket No. 18128)

The Commission herein has made two essential policy judgments which change the entire character of common carrier rates and services: these judgments are (a) that the public interest is not served by the present system wherein it is cogently argued that the ordinary rate-payer was the beneficiary of cross-subsidization from business users based on a "value of service" rather than a "cost of service" rate structuring technique; and (b) that marketplace competition is not possible in an industry where one of the competitors, of economic necessity, must also provide essential monopoly services. The telephone company will not be hurt by this action; it will continue to thrive. Any injury is to the consumer.

The foregoing, ultimate decisions are made, almost *sub silentio*, as inherent consequences of imposing the absolutely artificial requirement that a severe Fully Distributed Cost methodology be used to set rates irrespective of the fact that in the real world—particularly one in which vigorous competition has been recently injected—rates must be based on a plethora of marketing, pricing, social, political and growth strategy conclusions not given to dogmatic formulae and irrespective of the fact that pricing secondary, non-monopoly services at an artificially high rate in a competitive marketplace must mean a loss of business and the incremental revenues secured thereby which more than cover the marginal costs.

Nobody seriously contests the fact that we cannot permit, willy nilly, a regulated monopoly carrier to establish rates based on its own self-serving estimates of what the market will bear because of the obvious potential for abuse and the possible establishment of unjustly high rates. At the other end, a *laissez faire* approach to rates permits of predatory pricing and anti-competitive behavior antithetical to fair competition by a monopoly supplier with an unavoidable advantage. Somewhere there may be a regulatory program consistent with surveillance of monopoly pricing and provisions for ordinary business de-

cisions—in or out of a competitive arena. To even the most unsophisticated observer, the one established herein is no such program.

The Commission here, over all dictates of common sense, views of Congressional experts,[1] the practices of other regulatory agencies,[2] and the protestations of state regulatory agencies, has adopted a Fully Distributed Cost accounting method that is all but unyielding and defies every proven rule of economic logic. Virtually every economist-observer cited in this proceeding concedes that incremental costs methods are the closest approximation to a free market environment[3] and the courts have ratified the use of marginal cost pricing in the utility field.

I concede that there are imperfections inherent in monitoring marginal costing structures in terms of regulatory administration not present with a simplistic, Fully Distributed Cost basis. However, governmental decisions should not be predicated disproportionately on convenience to the government, but on the broader public interest.

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[1] For a clear, concise attack on the FCC's notions about using Fully Distributed Costs as a basis for ratemaking, the dangers of higher prices from such a system, the anti-competitive outcome sure to follow, and some intelligent alternatives *see Agenda For Oversight: Domestic Common Carrier Regulation, Prepared by the Staff for the Use of the Subcommittee on Communications of the House Committee on Interstate and Foreign Commerce*, 94th Cong., 2d Sess. at pp. 19-23, April 26, 1976.

[2] The Department of Justice contends:

> Since firms in a competitive market may find it more efficient to engage in marginal cost pricing, especially where they have substantial fixed costs, enactment of the bill could result in higher consumer prices and inefficient resource allocation. Moreover, enactment of a "fully distributed cost" criterion would limit firm pricing flexibility thereby fostering undesirable price rigidity.... Thus, it is particularly important that the definition of "cost" be an economically sound one which does not raise the risk of making firm pricing unduly rigid.

Hearings before the Subcomm. on Antitrust and Monopoly of the Sen. Comm. on Judiciary on S. 1457 92d Cong., 2d sess. 103 (1972). The ICC notes:

> To revise all rates so as to make them reflect exactly or approximately the fully distributed costs, if such a thing were practicable, would tend to dry up much of the traffic moving in large volume, with a consequent reduction in the contribution which this traffic now makes to the carrier's general revenue needs. Such a change would increase rather than reduce the portion of the general transportation burden to be borne by the higher-rated traffic.

U.S. Sugar Corp. v. Atlantic Coast Line R. Co., 277 I.C.C. 193, 202 (1950). The Chief Economist of the Federal Power Commission sagely observes:

> The weakness of a rate design in accordance with fully distributed cost is that its economic content is in reality a sham.... To design rates for the future on the basis of a preconceived allocation of joint costs is to preclude any consideration of selective rate adjustments which will promote increased use of facilities and possibly lower the rates to all customer classes.

Wald, "Theory of Marginal Cost Pricing and Utility Rates," 79 Public Utilities Fortnightly, 15, 20 (1967). The President's Council of Economic Advisors agreed with the above authorities and left no doubt that Fully Distributed Cost methods are arbitrarily conceived and will result in higher consumer prices.

> ... marginal costs rather than fully distributed costs would most closely approximate the pattern which a competitive market would produce. This principle, if generally applied, would result in a much more efficient distribution of transportation resources and in lower costs to users of transportation services.

1969 Economic Report of the President and Annual Report of the Council of Economic Advisors, p. 113.

[3] The record in this proceeding reflects the following, almost unchallenged view of Fully Distributed Costs:

> ... I think that it would be a little short of a catastrophe for the cause of the sound development of telecommunications in this country if a persistent and unyielding attempt were made to impose upon the Bell System an obligation to bring the revenues from each of its major classes of service into alignment with the costs imputed to each class by any kind of a total cost allocation (i.e., fully distributed costs).

Dr. James Bonbright, Professor of Finance Emeritus of Columbia University, has also taught at Harvard and the University of California, who served as Chairman of the New York Power Authority, and served as a consultant to the FCC and other regulatory bodies. In substantial agreement with this view were Dr. William Baumol, professor of economics, Princeton and New York Universities, Mr. David Kosh, Dr. Richard B. Johnson, Dr. William Vickery, Dr. J. Rhoads Foster and Charles W. King.

What was clearly called for out of this Docket was a system which allows flexibility, a forward-looking rate structuring, as opposed to the backward-oriented reliance on irrelevant history. Also needed is sufficient FCC expertise to review carrier projections to determine the accuracy and *bona fides* of anticipated costs and revenues. Instead, we have ordered *rigor mortis*.

From several public interest standpoints, this decision fails and the arbitrary nature of the result, which is in no way supported by the record in this proceeding, means the decision itself should fail. The first public interest conflict (at least, my view of the public interest) is presented by the categorical judgment implicit in this action that there can and should be no "value of service" approach which leads to cross-fertilization of the services and permits of a rate philosophy which is societally necessary and useful as well as being largely responsible for universalization of service at rates which benefitted the great mass of users. That approach, however, was singularly consistent with the foremost charge of the Communications Act "to make available, so far as possible, to all the people of the United States a rapid, efficient Nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges. . . ." 47 U.S.C. § 151. Because the costs of providing basic local and long distance message service[4] to the average residential subscriber are clearly higher than the rates now charged, it is obvious that the higher charges for commercial users were used to offset the deficits. An example of this phenomenon can be found in the majority's own decision which, even using Fully Distributed Cost methods, finds that WATS, in 1969, was earning 10.4% under FDC method 1 and 18.1% under FDC method 7 compared to a company-wide 7.8% rate of return. In 1971, the returns were 9.4% and 16.7% compared to 7.8% overall. *Majority Decision*, p. —.[5] Moreover, in 1969 TELPAK returned 9.6% (even under the useless and deceptive FDC method 1) and other private line telephone services returned 5.5%. *Id.* at p. —. Just imagine the magnitude of these results if an honest, incremental cost approach were applied. The true nature of the cross-subsidies are thus apparent. It is because the rates for commercial services (*e.g.*, business service offerings, terminal equipment) were not necessarily cost-based that competition in those fields became attractive to potential entrepreneurs and to large business customers. The list of current customers of the specialized carriers, naturally, coincides with *Fortune* magazine's "Top 500" companies. Indeed, a review of the transcript of the Oral Argument will confirm that the only parties seriously arguing for the application of Fully Distributed Costs were the specialized carriers and other competitors.

The problem with respect to competition by a monopoly was (and is, I acknowledge) the theoretical ability of the existing monopoly carrier to reach into the "deep pocket" of overall revenues and underprice competitive services, thus discouraging or breaking competition. However, the problem was created by the decision to inject competition for

[4] By basic services, I do not mean the so-called "lifeline" services in which a phone is available at a minimal monthly cost to be used essentially for emergencies; I mean the present service that most Americans have come to expect for "free"; *e.g.*, unlimited telephone use for a small, monthly charge, directory listing, expeditious maintenance and so forth.

[5] While WATS is a monopoly service, it is exclusively an institutional and commercial device which ordinary ratepayers do not utilize. The contribution to an overall rate of return from WATS is clear and beyond dispute.

the avowed purpose of stimulating innovation which a monopoly might be slow to adopt and to assist in keeping the monopoly "honest" in terms of rates and services. Having been the architect of the policy of competition, the Commission simultaneously created the dilemma of how to treat the conflict between the present system of subsidization of the ordinary rate-payer and this route of protecting the competition.

In requiring the use of Fully Distributed Costs, which mandates a rate structure absolutely keyed to historically recorded costs (with an arbitrary attribution of such costs) and divergencies therefrom only in extreme circumstances with nearly impossible showings, the majority—in certain contradiction to its previous expressions not to create a "protective umbrella" around competitors[6]—has opted for the protectionist policy. Thus, by requiring the carrier to realize the permissive rate of return on each and every service (with exceptions that are pragmatically meaningless), the Commission is cementing an arbitrary "floor" on competitive offerings by one competitor while no such requirement is placed on specialized carriers. These will be free to sharp shoot at the rates mechanically fixed by a Fully Distributed Cost methodology made mandatory on the other party. Clearly this is not competition; it is an unconscionable form of price fixing and market assignment which is obnoxious not only from any perspective of fair play and counter-productive to the original goals of competition, it should be declared plainly illegal.

By tilting the balance between simplistic accountability for rate structure and a flexible approach which permits of real market judgments and any socially useful cross-subsidy which might or could be present, the extreme remedy adopted herein is patently intended to preserve and protect an agency-created policy of competition. The Commission, of necessary consequence, has accomplished the following:

1. Prohibited a "value of service" approach which could be just as valid and relevant a pricing gauge as costs.
2. Prohibited cross-subsidization which has resulted in lower rates to average consumers, irrespective of any public interest arguments which have been otherwise made.
3. Abolished competition by creating an artificial rate structure which must be adhered to only by one party while others are free to shave prices to any degree necessary to secure traffic (without regard to fully distributing all costs) and still make a sizable profit.
4. Ultimately foisted higher costs on household subscribers because of the lost contribution of business revenues.
5. Throttled the ability of our major carrier to introduce new and innovative services at prices which, initially, might never (or not for many years) recoup full research and development, marketing and administrative costs, as well as achieve a rate of return prescribed for the company as a whole "in a time certain."

Once having created competition, I agree that there is no perfect way to preserve the benefits of the past monopoly system while at the

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[6] *See generally, Specialized Common Carriers*, 29 FCC 2d 870 (1971).

same time assuring absolute cost accountability and protecting competition. The original method 7 Fully Distributed Cost approach probably came as close to balancing the conflicting goals as any devised and might have worked. In so straight-jacketing method 7 with the restrictions set forth herein, we have unbalanced the equation beyond reasonability. *I wish to emphasize that I fully agree that benefits can and have come from competition and am not opposed to or fighting that concept.* There is room in this huge and growing industry for a large number and variety of suppliers. But this decision reflects not "full and fair" competition; it reflects a protectionist goal.[7] Those protected are not those which have been protected (*i.e.*, household subscribers) and, in light of my personal public interest perspective, I respectfully dissent.

STATEMENT OF COMMISSIONER ABBOTT WASHBURN ON DOCKET 18128 ORDER CONCURRING IN PART AND DISSENTING IN PART SEPTEMBER 23, 1976

I can concur only in that part of the Order directing AT&T and the Common Carrier Bureau to consult over the next three months in an effort to revise Fully Distributed Cost Methods #1 and #7 and forecasting techniques. At the end of that period the Commission will have an opportunity to scrutinize the results and appraise whether progress has been made.

Until we know the outcome of these consultations it would be imprudent, in my judgment, for the Commission to order revised rate-level filings for the major categories of interstate services--as the majority has done today, specifying a deadline of "within 8 months." In so doing, the Commission is stepping out in the dark.

It will remain unclear, until after these consultations, what consequences will flow from the new revised approach to costing. The decision document states on page 81: "the WATS rate level, nearly double that of the system, is clearly excessive." Under the new approach would WATS be reduced by as much as 50%, or by less, or not at all? At this point no one knows. The private-line telephone rate is found to be too low and illegal. TELPAK rates are held to be legal, but so low as to be discriminatory against private line. What happens if private line is raised to an acceptable legal level and TELPAK is raised to an acceptable non-discriminatory level? Will TELPAK then be too high and found illegal? Possibly, because the document on page 82 states: "We conclude that TELPAK rates are [now] recovering the full costs

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[7] Neutral observers have anticipated our unorthodox style of competition and commented on the FCC approach. A copyrighted research report released by the New York Stock Exchange firm of Sanford Bernstein & Co. explains:

> The extent to which new entrants to the market succeed in gaining share in either equipment or services *will likely be a function of how long and to what degree the FCC will hamper the telephone industry's ability to compete.* The risk of regulatory problems arising reflects AT&T's theoretical ability to subsidize services in competitive markets with excessive prices of monopoly services. Although it is obviously the Commission's position to support competition temporarily, at least until it can support itself, to over-extend this position would not only serve to defeat the original goal of a competitive environment, but would jeopardize a unique national resource for an uncertain benefit. (Emphasis added.)

"American Telephone & Telegraph Co., 1976-1977 Earnings Forecast. January 28, 1976 (authored by Steven G. Chrust) at pp. 13-14.

associated with providing the service." But again, at this point no one really knows.

Turbulence in rates, therefore, appears to be a likely consequence, accompanied by uncertainty and confusion on the part of both the users and the telephone companies. If so, it is hard to see how the public interest will be served.

Recognizing that the Commission had to make a choice between methods, and that real and very practical problems are associated with the implementation of true Long Range Incremental Costing, I believe the FDC #7 methodology offers a viable approach. In addition it will result, for the first time, in the Commission's obtaining comprehensive cost data on the full range of interstate services. The public and the telephone industry would have been better served, however, had we (1) clearly designated Modified FDC #7 as a way-station on the road to a methodology that would more faithfully produce the results of open competition, and (2) fully committed ourselves to the further development and perfection of such an approach.

We should remember that regulation is intended to be a substitute for competition; that firms subject to full competition price on an incremental basis; and that incremental pricing produces efficient allocation of resources with its attendant benefits.

Appendix H

Common Carrier, Rates, Charges, see also Tariff
Private Line Service
Staff Participation In Proceedings
Telpak

Petitions for Reconsideration of 61 FCC 2d 587 granted in part. Fully Distributed Cost Method 7 is applicable costing and rate-making standard for multi-service carriers. Reconsideration granted on competitive necessity for TELPAK rate discrimination where notice of same is insufficient. Delegation to staff to consult with carriers for decision implementation approved. (Sec. 0.291 and 0.91(2) and (G)).

F.C.C. 77-385

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of AMERICAN TELEPHONE & TELEGRAPH COMPANY, LONG LINES DEPARTMENT Revisions of Tariff FCC No. 260 Private Line Services, Series 5000 (TELPAK)	Docket No. 18128

MEMORANDUM OPINION AND ORDER

(Adopted: June 6, 1977; Released: June 13, 1977)

BY THE COMMISSION: COMMISSIONER HOOKS DISSENTING; COMMISSIONER WHITE CONCURRING IN THE RESULT.

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1. Introduction

1. On October 1, 1976, we released our Memorandum Opinion and Order [1] ruling on and disposing of long-pending questions as to the lawfulness of rate levels [2] and rate level relationships of each service category of the American Telephone and Telegraph Company (Bell) subject to our jurisdiction, the most appropriate basis or methodology to measure the full cost of providing service and the lawfulness of Bell's TELPAK bulk-rate discount private line service. Seven petitions for reconsideration and/or clarification of our Decision were filed. [3] Six oppositions [4] and four replies [5] are also before us.

2. At the outset it may be useful to emphasize the scope of this proceeding and its relationship to our rulings herein. Specifically, while certain rate levels were at issue and were decided herein, this is not primarily a typical "rate case" designed to test the lawfulness of specific charges, nor a "rate-of-return" proceeding designed to establish an appropriate earnings ratio on investment. Rather, the purpose and effect of this proceeding is to establish basic principles and standards of general applicability for determining cost of service and corresponding rate levels, by service category. This case constitutes further delineation and clarification of our statutory obligation to determine and in certain instances prescribe "just and reasonable" [6] rates, thus assuring carrier accountability to the public for its rate actions. Our Decision is also intended to promote innovation and efficiency in telecommunications common carriage. Thus, we stated:

> We find our obligation to promote [efficiency] and innovation to encompass cost definition, minimization, and allocation. Furthermore, we recognize the interdependence of efficiency and costing. We do not limit our consideration of efficiency only to measurable transactions, but realize that the public interest may be served by recognizing [such] factors [as] . . . considerations [of] equity and social welfare. It is, therefore, broader than that espoused by economists or individual carriers. 61 F.C.C. 2d at 615.

A. Summary of Holdings

3. Our Decision may be broadly summarized as follows:

(1) "Fully Distributed Cost" (FDC) is the costing approach most consistent with our objectives under the Act, and should be the basic standard by which the justness and reasonableness of rates will be judged (61 F.C.C. 2d at 589);

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[1] *AT&T Private Line Rate Cases*, 61 F.C.C. 2d 587 (1976); referenced hereafter as "Decision."

[2] The issues herein were designated in terms of "rate levels." *Id.* at 596. In this context, rate level "refers to . . . percentage return on investment." The phrases "earnings ratio," "return level," "return on investment" and "return" are all to the same effect (*see* 61 F.C.C. 2d at 650, n. 86).

[3] Petitions for reconsideration were filed by American Telephone and Telegraph Co. (Bell), The Western Union Telegraph Company (Western Union), Aeronautical Radio, Inc. (ARINC), Air Transport Association of America, Inc. (ATA), United States Transmission Systems, Inc. (USTS), the Department of Defense and all other Federal Executive Agencies (DoD) and the Aerospace Industries Association of America, Inc. (AIA).

[4] Oppositions to the above petitions were filed by Western Union, Bell, the National Association of Broadcasters (NAB), Microwave Communications, Inc. (MCI) and by ATA and ARINC jointly as the "airline industry parties"; American Broadcasting Companies, Inc., CBS, Inc. and National Broadcasting Company, Inc. ("the network parties") collectively filed a "response" to petitions for reconsideration which we treat as an opposition.

[5] Replies to oppositions were filed by Western Union, Bell, USTS and by ATA and ARINC jointly.

[6] *See* 47 U.S.C. §§ 201(b), 205 (1974).

(2) FDC Method 7's historical cost causation basis of allocating costs is most consistent with our mandate to ensure just, reasonable and non-discriminatory rates (*ibid.*;)
(3) Certain revisions to Methods 7 and 1 are required to correct infirmities observed during the course of these proceedings and to align these methods with prescribed guidelines and standards (61 F.C.C. 2d at 589-90); Bell was directed, in consultation with the staff of the Common Carrier Bureau (CCB staff), to correct these infirmities and to revise FDC Method 7 according to Decisional guidelines (*id.* at 668);
(4) Forecast assignments of new plant established in accord with the cost-causational revised Method 7 will subsequently be tested for accuracy using Method 1-based experienced-use data (*id.* at 587, 667);
(5) Discriminatory rates may be justified by competitive necessity. The two applicable competitive necessity criteria are: (1) that those benefitting from the discrimination have an alternate supply source which will be utilized in the absence of discrimination and, (2) that the discrimination benefits users discriminated against (*id.* at 590);
(6) The lawfulness of TELPAK was before us and our Decision held that this specific bulk discount discrimination was not justified under the proper competitive response criterion of the competitive necessity test. Although Bell was ordered to terminate TELPAK, we held that Bell may file a new appropriately responsive bulk offering consistent with our Decision's guidelines (*id.* at 659);
(7) Bell was ordered to refile tariff rate revisions for *all* services in order to yield rate levels in accordance with the costing guidelines and methodologies specified in the Decision (*id.* at 668). As a basis for determining the full costs related to these general filings and all future filings, Bell was directed to assign all extant plant, by service category, to a facility "datum." No departures from full cost rates are permissible absent grant of a waiver (*id.* at 590-91, 666-67).

B. Contentions of the Parties

4. With the exception of USTS, all of the petitioners have participated in the hearings below. The parties before us are either major customers of Bell (*e.g.*, ATA, DoD, AIA, ARINC, the Networks and NAB) or are competitors of Bell (USTS, Western Union and MCI). The following are brief summaries of petitioners' contentions.

Bell

5. Bell prefaces its petition with the statement that it does not challenge our Decision's choice of FDC Method 7, the FDC guidelines or the implementation process where we directed Bell to consult with the staff on refinements to Method 7 which would underlie its June, 1977 tariff filings. Bell requests reconsideration of only two issues. First, Bell asserts that FDC should not be held to be the "immutable standard" for determining whether rate levels are compensatory, stating

that users of other services may still benefit when certain services are priced at "a somewhat lower FDC level." [7] Further, Bell contends that departures from the FDC standard should not be considered in tariff filings, but "in proceedings where all pertinent evidence can be presented." Second, Bell asserts that our finding that the record fails to support the competitive necessity for the nationwide TELPAK offering is improper on the ground that the competitive necessity for TELPAK had already been decided in 1964 and could not be reappraised.

Western Union

6. Western Union asserts that standards governing future bulk offerings, Method 7, our guidelines for revisions and the way in which Method 1 will be used in conjunction with Method 7 are "imprecise." We are urged to decide whether and how Method 7 applies to other carriers, to initiate an investigation into the bulk offerings of other carriers and to reconsider our choice of Method 7 and adopt instead Method 1 in accordance with the Recommended Decision (RD) of the Chief of the Common Carrier Bureau, released January 19, 1976.

7. Western Union also contends that the consultations between Bell and the CCB staff constitute an unlawful delegation of Commission ratemaking responsibilities. Finally, Western Union criticizes Bell's FDC Manual as failing to adhere to our Decisional guidelines.

ATA

8. ATA requests that we provide additional reasons for not employing its "Accommodation Theory" as the appropriate costing methodology. It joins Bell in asserting that our rulings respecting TELPAK should be reconsidered. It also seeks a ruling on TELPAK refunds, the standing of Method 1 vis-a-vis Method 7, and objects to both our direction that Bell consult with the staff on its FDC Manual and the Manual's faithfulness to the Decision.

DoD

9. DoD has determined not to seek reconsideration of the prescribed costing methodologies, preferring instead to concentrate in the context of reconsideration on the TELPAK issue. DoD emphasizes that it occupies a unique position in this case since, by a recent study, it has determined that its AUTOVON system and Government Services Administration's (GSA) Federal Telecommunication System (FTS) utilize approximately 65% of the circuits of the present TELPAK network. DoD estimates an increase in its charges for communications services of $7 million per month upon removal of the TELPAK discounts. It asserts that the decision on TELPAK impacts the Federal agencies more than any other Bell customer with the result that special attention should be paid to its arguments for a continuation of TELPAK in its present form.

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[7] Bell Petition at p. 7. Bell's use of the words "immutable" and "absolute" to describe our Decision's choice of fully distributed costs as the standard for determining whether rates are compensatory is ambiguous. In urging that FDC should not be the "immutable" or "absolute" standard, it is unclear whether Bell seeks to depart from this standard by use of marginal cost-related rates, or whether its FDC rates for certain services will be designed to earn a return less than the company's overall allowed rate of return. Bell is required to follow the guidelines provided in our Decision but, waiver requests which can be shown to be in the public interest will, of course, be granted.

10. DoD alleges that the record supplies ample support for a finding that TELPAK was competitively necessary, and that evidence to the contrary was "four years old" at the time of our Decision and did not reflect the "virtual revolution in the communications industry." DoD asserts that our designation order establishing Docket 18128 affirmed previous findings of competitive necessity and contemplated only the question whether TELPAK rates were compensatory. DoD characterizes our competitive necessity holding as an attempt to decide matters not properly at issue. Finally, DoD urges that each service should not be required to earn a return equal to that of the firm's authorized rate of return.

USTS

11. USTS urged us to rely on Method 1 rather than Method 7, but stated in the alternative that Bell's FDC Manual should require the concurrent filing of Method 1 with Method 7. It contends that some aspects of our Decision are at variance with our Decision in Phase II Docket 19129,[8] and requested that we issue an "unequivocal" statement that the Manual is open to challenge in any future proceeding.

ARINC

12. ARINC, as a major customer of TELPAK, asserted that our TELPAK findings are contrary to the evidence and that there is competitive necessity for Bell's nationwide bulk offerings, or alternatively, that our 1964 Decision[9] is *res judicata*. ARINC also takes issue with Bell's consultations with the staff on the FDC Manual and contended that the contents of the Manual are contrary to our Decisional guidelines. ARINC requests that the lawfulness of teletypewriter station equipment and reductions in the TELPAK telegraph-grade voice equivalency be decided.

AIA

13. AIA, also a substantial TELPAK customer, urges us to reverse our TELPAK holding, citing reasons similar to those posited by ARINC, DoD and ATA.

Oppositions and Replies

14. MCI filed an opposition to the petitions of ARINC, DoD, AIA, ATA and Bell. MCI criticizes our choice of Method 7 as well as the contents of Bell's FDC Manual, contending that Method 7 will not provide an effective check on the alleged ability of monopoly services to subsidize competitive services, and suggested the concurrent filing of Method 1 data for this purpose. MCI objects to Bell's position that revised FDC Method 7 should not be the "immutable" standard for judging the lawfulness of rates on the ground that:

> Clearly, a single methodology must be employed to produce rates irrespective of any additional benchmark studies that may be made for purposes of listing and comparision. MCI Opposition, p. 11.

15. MCI supports our ruling on TELPAK, stating that the large-user parties ignore the fact that it is the Commission's Decision on

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[8] F.C.C. 77-150, released March 1, 1977.

[9] 38 F.C.C. 370, 37 F.C.C. 1111 (1964), *aff'd sub nom. American Trucking Ass'ns v. F.C.C.*, 377 F.2d 121 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967).

resale and shared use [10] which will probably render the further provision of TELPAK economically infeasible for Bell. "Indeed, resale and sharing are the normal economic responses of the marketplace to an irrational price structure that fails to reflect cost realities." MCI Opposition, p. 11. Relative to whether TELPAK's lawfulness under the proper competitive response criterion was at issue, MCI states that "it is frivolous to contend that there was no notice to the parties that competitive necessity was at issue." *Id.* at 17.

16. The Networks challenge Western Union's and USTS's preference for Method 1, citing portions of the record and our Decision. The Networks join Bell in requesting clarification of whether FDC is the "absolute" standard for determining whether rates are lawful, but limit this issue to the context of pricing departures which fall *below* the FDC standard. Networks' Response, p. 22.

17. Bell opposes ATA's contention that it is entitled to a refund on the ground that TELPAK rates have been unlawfully high, on the basis of Rulings on Exceptions and the fact that the TELPAK users have had the benefit of a lower rate for a "like" service with private line. Bell Opposition, p. 4. Bell also states that evidence in the record fully justifies the 1968 and 1970 changes in the TELPAK telegraph-telephone equivalency ration and the 1968 rate increases for teletypewriter station equipment. *Id.* at footnote. Bell asserts that no record evidence exists for the position taken by Western Union and USTS that Method 1 should be adopted instead of Method 7. *Id.* at 5. Relative to its consultations with the CCB staff on revisions to the FDC Manual, Bell stated that participation was properly limited to the staff, Bell and its independent telephone company "partners" and that its Manual conforms to the Decision's guidelines.

18. Western Union limited its opposition to the user-parties' and Bell's contention that the competitive necessity for TELPAK had already been decided, and asserted that legally, and ". . . as a practical matter," the parties and this Commission "recognized throughout this proceeding that the alleged competitive necessity for TELPAK was at issue." Western Union Opposition, p. 3.

19. The NAB addressed its opposition to the issue raised by Bell that FDC should not constitute the "absolute" or "immutable" standard against which to measure whether rates are compensatory or whether interservice subsidy exists. NAB asserts that "the Commission's *Decision* was not perceived as establishing an absolutely rigid and inflexible costing formulation" (NAB Opposition, p. 2) and that "it is apparent that [program transmission rates] cannot withstand strict adherence to the FDC criterion." *Id.* at 5. NAB thus seeks clarification of this issue.

20. ATA and ARINC (collectively the Airline Industry Parties) first oppose the argument made by Western Union and USTS that Method 1 rather than Method 7 should have been chosen as the FDC allocation standard, and discuss the points made by Western Union relative to Bell's FDC Manual and its adherence to our Decision.

21. In their replies, Western Union and USTS reiterate their pref-

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[10] *Resale and Shared Use of Common Carrier Services and Facilities* (Docket 20097), 60 F.C.C. 2d 261 (1976), *reconsideration denied in part*, 62 F.C.C. 2d 588 (1977), *petition for review pending, sub nom. AT&T v. F.C.C.*, No. 77-4057 *et al.* (2d Cir.).

erence for Method 1, the Airline parties again argue the competitive necessity for TELPAK and its benefit to other users, and Bell reiterates its position on the propriety of Method 7 and its criticism of our ruling on the competitive necessity for TELPAK.

II. Record Support for Prescribing FDC Method 7 and the Use of FDC Method 1

22. In this section we respond to assertions that our Decision does not find a sufficient basis in the record for defining Method 7's principle of historic cost causation and that we did not effectively dispose of certain matters at issue. These claims are not well taken. Our Decision has resolved the issues in this proceeding and does in fact provide the foundation for filing revised carrier-made rates according to full service costs.

23. In Sections V-VIII (61 F.C.C. 2d at 605-18), we set forth the statutory, legal and policy grounds of our selection and prescription of ratemaking standards, principles and guidelines. We have expressed our intention to select the costing methodology which best reflects our statutory mandate, concluding that:

> Of the seven FDC Methods of record, Method 7's historical cost causation basis of allocating costs is determined to be most consistent with our mandate to ensure just, reasonable, and nondiscriminatory rates. *Id.* at 589.

24. We emphasize the general applicability of our findings. The record before us focused on cross-subsidization between monopoly and competitive services and an industry structure characterized by emerging competitive forces. However, our underlying philosophy extends equally to other extant possibilities of cross-subsidization and to those which would be made possible by further development of the industry, restructure of service offerings by regulated carriers, technological changes, or other events. *Id.* at 638.

25. FDC methods were held "the *standard* of ratemaking" (*id.* at 641; emphasis in original) and we made clear that Bell was to base its future rate levels, rate relationships and changes thereto on FDC Method 7 data. *Id.* at 649.

> We held that:
>
> [T]ariff filings should reflect their overall impact and effects, and should be based on data employed in a consistent manner between services and over time. Bell must exhibit methodological consistency and supply comparable supportive materials for future rate filings of *all* the various Bell services in accordance with the guidelines established herein. *Id.* at 641-42; emphasis supplied. [11]

26. We thus required that revised tariffs which incorporate our FDC guidelines into rates and rate relationships were to be filed with the "*minimum* materials required to support rate levels and departures from datum-based full costs." *Id.* at 663; emphasis in original. "Full cost," of course, includes cost of capital. *Id.* at 619-21. *See also,*

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[11] Upon experience gained on this record and through our Decisions in *Hi-Lo*, 55 F.C.C. 2d 246 (1975), *DDS*, 62 F.C.C. 2d 774 (1977) and *WATS*, 59 F.C.C. 2d 671 (1976), we held "disparate and incongruous ratemaking concepts . . . unlawful." 61 F.C.C. 2d at 662. We specified that "the breadth of supportive" materials required for tariff filings should show "overall" impact, including proper estimates of cost function changes and cross-elasticity data. *Ibid.* Such data must allocate the totality of Bell's plant and expenses among all services. Plant and expense totals must be derived from data of a recent test year; it cannot be based on results of prior test years "factored forward." Furthermore, the recent test year must be the *same* for all services.

Communications Satellite Corp., 56 F.C.C. 2d 1101, 1145 (1975). Thus, to comply with our Decision, each tariffed service category's rates must be targeted to yield an expected return level equal to the carriers' authorized overall return, absent a proper showing under the general provisions of the waiver process. This waiver process is intended to recognize instances where the public interest may be served by departures from full cost rates. *Id.* at 608, 662-63. For example, "carrier pricing flexibility may be warranted in situations where less-than-full cost based rates will permit beneficial cost efficiencies and demand adjustments over time." *Id.* at 663. However, the "full recorded costs of operations" (*id.* at 661) are to be covered for each service category unless a waiver is granted. Even with the waiver process, it is abundantly clear that our prime emphasis is on carrier accountability for its rates. *Id.* at 610. "[A]ccountability is the touchstone of the 'just and reasonable' provision of Section 201" of the Act. *Id.* at 612. Further, "accountability . . . involve[s] consistency in forecast and actual methodology and in the dimensions of the data employed[,] . . . across all services. . . ." *Id.* at 612. [12]

27. Grant of a waiver requires that the carrier be able to reconcile and account for any requested departures from FDC Method 7 full costs in relation to datum-based investment assignments and an allocated share of expenses. [13] In the competitive area, departures below the overall authorized return level will be considered in exceptional circumstances. [14] *Id.* at 666. On the other hand, departures above the overall level of return can be supported by appropriate justification.

28. We note that the use by carriers of projections and forecasts of changes in demand have logically provided management with the basis

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[12] Chairman Wiley has commented as follows on the public safeguard features of accountability:

> Once the costs of each of AT&T's services are identified, regulatory agencies, the Congress, and the American people will be able to make fundamental decisions concerning the desirability of subsidies between classes of users. These decisions can then reflect conscious social and political judgments made with the full knowledge of all consumers. 61 F.C.C. 2d at 669.

[13] We have held Bell's "basic service philosophy" of ratemaking unlawful. Consequently, supportive materials for "revisions to any existing service rate level or rate relationship . . . must be supported by a showing of *overall* impact of such revisions . . . for each of the various Bell services." This relates to "plant responsibility [which] impacts directly on realization of Commission objectives and responsibilities." 61 F.C.C. 2d at 662; *see also* 61 F.C.C. 2d at 591, 627, 661-63 and 666. Reconciliation of datum-based assignments is relevant in the context of (1) rate filings, (2) reconciliation between forecast and actual plant assignments at regular intervals and (3) upon review of proposals for datum reassignments submitted by other carriers or interested parties. See *id.* at 655.

[14] Waivers will generally be considered within the context of tariff proceedings. Waivers must be properly supported by materials as specified in our Decision concerning use of disparate ratemaking concepts. *Id.* at 661, *et seq.* Where applicable, Bell must provide materials which will allow us to determine the full impact of any waiver of the requirement that the service cover its full costs, including a showing of the incidence, by service of any revenue requirement burden associated with a grant of the waiver. These materials shall support both the rate levels petitioned for by waiver and rate levels corresponding to the then prevailing authorized return levels. A showing that any shortfalls will be made up within "a reasonable time certain, and that the departure will benefit the body of Bell's users" is also to be made. *Id.* at 666. The requirement to recover shortfalls over time is generally applicable to departures below full costs, when it is practicable to recover full costs for the service category. It would not generally be applicable to those services where rate changes would not improve the level of return or where a preferential rate may be sanctioned or where a waiver may be granted to exceed the company's authorized return. We take note of our intention to undertake rulemaking in conjunction with the Uniform System of Accounts under which specification of supportive records, accounts, subaccounts, and traffic and other data will be examined. USOA revisions should also provide us with data, records and accounts for waiver process reconciliation and accounting.

for budgeting, committing and disbursing capital for the installation of facilities used to provide service. When expended, these costs become embedded, and associated expenses such as depreciation, maintenance and general and administrative are incurred. See *id.* at 633. This is the underlying philosophy of historical cost causation embodied in our prescribed methodology. The carrier may base its rates on the datum mix of embedded and forecast plant requirements to meet projected changes in demand. Subsequent analysis of experienced-use plant data (revised Method 1-type data) will provide the basis to determine the accuracy of forecasts. Thus, although ultimately accountable for its pricing decisions, management is given the flexibility to forecast future plant requirements and calculate rates, in part, in relation to these forecasts. Method 7 envisions allocation and attribution at the inception of this causal chain. Thus Method 7 was found to reconcile best the divergent needs of flexible management decision-making and public accountability. [15]

29. The carrier's rate base investment is distributed to a facilities datum by service category on the basis of both current and projected use:

> The method to be used for the allocation of facilities costs . . . must be one of assigning such facilities on the basis of historical causation to all services. . . . [T]he carrier must provide evidence of causation for facilities currently in place. . . . Projected usage is important here. . . . This process will constitute a 'datum' which will provide the basis for future [rate] actions. . . . [F]acilities . . . which are directly attributable shall be assigned to the respective services. Newly completed common facilities shall be assigned to the pertinent service categories on the basis of the projected circuit use accounted for by each service. We believe that such a procedure most closely parallels the concept of historic cost causation. 61 F.C.C. 2d at 664-5; footnote omitted.

While the revised methodology we have prescribed is intended to maximize the use of cost-of-service principles, assuring the fullest possible extent of attribution and cost assignment to each tariffed category of service, we view specific allocation procedures as continually subject to evolution and refinement in accordance with our guidelines, principles and standards. [16] It is a "dynamic, continuous process." *Id.* at 665.

30. In sum, the substantive record support for FDC Method 7 is evident from our Decision. *Id.* at 642-48. We specifically approve the

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[15] These concepts taken together underlie our Decision. Management retains the right to make investment, service offering and other decisions in the interests of its stockholders and investors, but remains accountable for its rate and pricing actions as it would within a strictly competitive marketplace. Use of revised Method 7 procedures provides a surrogate for the marketplace and its public interest aspects. 61 F.C.C. 2d at 609-12. We have recognized that investment and facility allocation decisions are fundamental to this objective, and have directed the establishment of a facilities datum and the reconciliation of forecast data and actual plant usage data. These reconciliations will be made part and parcel of our actions regarding subsequent facility construction applications and will be incorporated into our examination of the actual utilization of facilities in place. *Id.* at 664-65. It will include review of plant utilized by the carriers themselves such as test and administrative circuits. USOA revisions made in conjunction with our intended rulemaking in this area should also provide us with data to assess the appropriateness of service category definitions.

[16] Ratemaking approaches may not be rejected for lack of perfection as some parties imply in their petitions. We have chosen a methodology which is reasoned, nonarbitrary and best capable of achieving our objectives under the Act. Further, we envision that Method 7 will more precisely fix cost-responsibility as it evolves over time. See, *National Association of Greeting Card Publishers v. United States Postal Service*, — — F.2d — — (D.C. Cir. Slip. Op. No. 1856, Decided December 28, 1976) at p. 43.

allocative basis of historical cost responsibility, over time (*id.* at 642-43) with its inherent retrospective and prospective aspects. We have noted that the causational features of Method 7 appear ostensibly to incorporate some of the attractive characteristics of marginal costing, particularly since it incorporates the feature of "projected service usage . . . into an FDC framework." *Id.* at 646.

A. The Selection of Method 7 over Method 1

31. Western Union, USTS and MCI advocate the selection of Method 1 over Method 7 as the applicable costing standard. This was the methodology before us on recommendation of the Chief of the Common Carrier Bureau (see, *Recommended Decision of the Chief of the Common Carrier Bureau*, released January 19, 1976).

32. Our choice of Method 7 over Method 1 as the standard for cost of service analysis is supported by "substantial evidence." *Cf., Nader v. F.C.C.*, 520 F.2d 182, 199, n. 17, 204, n. 23 (D.C. Cir. 1975). Comparatively speaking, FDC Method 7 possesses all the attributes of our statutory objectives and responsibilities, without Method 1's inherent shortcomings. In particular, it will further the efficiency, innovation, fair competition and accountability objectives stated in the Decision. As revised, Method 7 will use forecast data and causational cost allocation mechanisms which should closely correlate with efficient management decision-making processes. 61 F.C.C. 2d at 614-15, 645-46. Causational aspects incorporated into the facilities datum permit the tracking of management plant assignment decisions over time and their alignment with actual results. *Id.* at 644-49. By way of contrast, Method 1 intrinsically relies on information of a past or historical context. Total reliance on information of this type as the basis of tariff filings cannot reflect all aspects of an efficient decisional process, nor provide management with the proper costs and criteria with which to compete in the marketplace. We have recognized the value of retrospective experienced-use information for accountability purposes as a check on the prospective plant assignment process. *Id.* at 667. However, this limited use of such data does not deny that "our primary FDC Methodology for the determination of the justness and reasonableness of rate levels and the rate relationships will be based on the logic of historical cost causation." *Id.* at 667. Principles of carrier accountability, fixity through the datum device and equity ring clear throughout our Decision. See, *e.g.*, *id.* at 662-67. Our Decision holds promise of rest and repose over long-pending costing controversies. It incorporates elements of marginal cost pricing without sacrifice of the regulatory advantages of verifiable, fully distributed cost data. We thus expect our Decision to facilitate and expedite future rate proceedings before us. *Id.* at 665.

33. In summary, while Method 1's inherent shortcomings illustrate that it cannot fix cost responsibility prospectively as can Method 7, we, as noted above, have not "discarded" experienced-use information derived from Method 1. We will periodically compare experienced-use-based assignments of plant to historic causation assignments for evidence of "gross imbalances." *Id.* at 665, 667. In the final analysis, we shall determine the validity of datum plant assignments upon periodic

examination (*id.* at 665) using Method 1 type data in the context of return levels.[17]

34. Certain revisions to Method 7 costing procedures of record (see Bell Exh. T-9 and T-10) were indicated. We found, for example, that Method 7 must be made more consistent with a true historical causational base, that it must be made less susceptible to managerial interpretation and manipulation and that the procedures employed must be generally clarified and delineated to our satisfaction. *Id.* at 646-47, 664-65. We thus directed Bell to develop acceptable forecasting techniques and, in consultation with the staff of the Common Carrier Bureau, appropriately revise Method 7 costing procedures and Method 1. *Id.* at 591. The staff was directed to report the results of the consultations to us within three months. *Id.* at 668.

B. The Extent of Prescription and the Directions to the Staff

35. We now consider, in connection with the extent of our prescription, questions raised respecting Bell's consultations with the CCB staff and the status of Bell's FDC Implementation Manual. As indicated, in prescribing FDC Method 7 we observed that, as then constituted, it admitted of certain infirmities. Accordingly, we prescribed specific guidelines for the revision of Method 7 (see, *e.g.*, 61 F.C.C. 2d at 667) and directed consultations between the carriers and the staff (*id.* at 668) so that the carriers would obtain a clear understanding of the Decision and consequently effect the revisions we ordered. We now discuss contentions that the consultations were an improper delegation of authority properly residing only in this Commission. It is claimed by some parties that the contents of the FDC Manual more properly belong in our Decision or, in the alternative, that the process by which Bell consulted with the staff to develop the manual should have included the several parties to Docket 18128 as active participants.

36. We make clear that the specifics of the manual will be subject to our full scrutiny. We have not, as some parties contend, "accepted" the manual. It was the *report* of the Cost Analysis Task Force that we "accepted." *Order* (F.C.C. 77-110), released February 14, 1977. We stated then, and affirm now:

> The burden of justifying rates and costing techniques remains with Bell in accordance with statutory and legal standards. The results of the consultative process are thus not binding on the Commission or on staff elements charged with rate evaluation and hearings; rights and remedies related to the rates filed in compliance with our Docket 18128 Decision are subject to our Rules and Regulations. *Ibid.*

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[17] Within the context of return levels, this process logically envisions comparison of Method 7 datum plant assignments and experienced-use data (i.e., a comparison of forecast and actual results), with expenses and revenues held constant for this purpose. Enough data will be provided to allow for the comparison of cost causational and experienced use based return levels. Comparison of return levels will indicate "gross imbalances" and thus provide signals as to whether plant assignment revisions among the datum categories are warranted. It is expected that the procedures for performance of revised Method 7 studies will maximize all opportunities for cost causational attribution of direct (nonfungible) and other expenses. Consequently, it is expected that such procedures will be the only basis for attribution of expenses. The Commission, *sua sponte*, carriers and other parties may propose and submit evidence respecting datum assignment revisions. 61 F.C.C. 2d at 665. Redistribution of plant assignments will be handled so as to preserve the datum's assignment integrity. As a result of the reconciliation process, actual assignments may supersede causational assignments to the extent that a proper showing has been made. *Id.* at 612, 641 and 662. Where applicable, gross imbalances will be estimated in terms of their cumulative historical revenue requirement effects. The carrier will then present a plan to redistribute future revenue requirements in such a way as to eliminate these effects over time.

37. The manual was the subject of a report by the Cost Analysis Task Force established by the Chief of the Common Carrier Bureau for compliance with paragraph 241 of our Decision. 61 F.C.C. 2d at 668. The report describes, in general terms, the content of the FDC implementation Manual, but the manual itself was not transmitted, nor is it otherwise before us at this time. The report states that the manual will underlie the rates Bell has been ordered to file under our Decision. Claims respecting the specifics of the FDC Implementation Manual and its conformance to the Decision will properly be before us in connection with Bell's tariff rate revisions, based on the manual. Until such time, contentions addressing the manual are premature. When filed, Bell's tariff rate revisions and underlying support (including its FDC Implementation Manual) will be subject to all rights and remedies under the Act, our Rules and Regulations and governing decisional law.

38. The delegation to the staff was wholly proper. See Section 0.291, 47 C.F.R. § 0.291. Specifically, our delegation to the Common Carrier Bureau under Section 0.91(e) and (g) of our Rules and Regulations, 47 C.F.R. § 0.91(e)(g), includes advising and assisting members of the public and the carriers on Commission policy and regulations. The Bureau also may obtain from the carriers full and complete information necessary to enable the Commission to perform the duties and carry out the objects for which it was created. This constituted the extent of the staff's authority. The staff had no power to bind this Commission.

39. Effecting the necessary rate revisions in relation to full costs to comply with our Decision remains within the purview of the carriers' management. Neither the record nor any specific costing methodology before us was at a level of perfection to allow the specific prescription of rates. We therefore have not exercised our full prescriptive powers under the Act. We have not disturbed the presumption of carrier-made rates on which Sections 201-204 of the Act are bottomed. For the future, it appears that the Commission's capability to prescribe rates will be enhanced by refinement and implementation of the costing principles in our Decision. At the present we see no reason to prescribe specific rules of allocation. Such rulemaking could, of course, be undertaken if future circumstances warrant.

40. We also reject contentions raised by Bell's customers and competitors respecting the right actively to participate in the consultative process. In the report of the Cost Analysis Task Force (p. 2) it is stated that:

> Bell and its partners actively participated with the staff at these meetings. Bell's customers, competitors and others were permitted to attend and observe, but not participate, because the consultative process involved the formulation of revised cost allocation procedures, which in turn, were to be used to support revised rates and charges.

41. As reported by the Cost Analysis Task Force, the consultations between Bell, its independent telephone company partners and the staff were open to the public. Minutes of the meetings were maintained and distributed to all those interested in the consultations. Report of the Cost Analysis Task Force, p. 3. Comments and suggestions were taken from the non-participants at various stages. *Id.* at p. 2. Those interested in challenging Bell's revised rate levels will be able to use the knowledge gained from these public consultations when the

rates employing the manual are before us. We find that the extent of participation and observation afforded Bell's customers and competitors was fair and appropriate under the circumstances and consonant with clear market rules. [18]

III. The Lawfulness of Bell's Bulk Discount Private Line Tariff (TELPAK) under Section 202(a) of the Act

42. We are urged to reconsider our Decision that Bell has not met its burden of proof under Section 202(a) of the Act on the lawfulness of TELPAK, a tariff category which offers private line service at a discounted, bulk rate. [19] We required Bell to justify its discriminatory pricing technique, nationwide in character, by meeting the "competitive necessity test." The test has two criteria:

(1) That those benefiting from the discriminatory pricing have an alternative of satisfying their communications requirements from a substitute source of supply and that they will shift to the substitute source unless the discrimination is maintained (the proper competitive response criterion); and
(2) That the discrimination benefits the users of the carrier's services who are discriminated against, i.e., charges to other users are lower because of the discriminatory rate than they would be without such rates (the compensatory/beneficial criterion). [20]

We found under the first criterion that the record in this proceeding failed conclusively to demonstrate "that the TELPAK offering as presently structured, constitutes a proper response to the extent of competition posed by private microwave," and that "while growth in specialized carriers and satellites might justify [TELPAK as a proper] competitive response in the future, this uncertain probability is not sufficient to justify the present TELPAK offering." [21] It is thus evident that our concern was with the specifics of TELPAK as a pervasive and ubiquitous response to the actual threat of competition from private microwave and specialized common carriage. We ordered that TELPAK in its present form be terminated, although Bell was afforded the opportunity to file another bulk offering (a replacement for TELPAK) consistent with our Decision. [22]

43. Reconsideration is urged on two grounds: (1) that there was not a substantial record basis for our holding and (2) that there was insufficient notice of the continued pendancy of the proper competitive response criterion. The parties state that the return levels for TEL-

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[18] We have stated that "clarification of market rules" (61 F.C.C. 2d at 615) in furtherance of our *Specialized Common Carrier Decision*, 29 F.C.C. 2d 870 (1970) was a "major objective." In such Decision, we put parties on notice of "our objective to promote and maintain an environment within which existing and any new carriers shall have an opportunity to compete fairly and fully in the sale of specialized services. Our ratemaking and regulatory policies and practices will be appropriately adapted to accomplish this objective" in Docket 18128. *Id.* at 915-16.

[19] Those requesting reconsideration of our TELPAK holding are Bell, DoD, AIA, ARINC and ATA.

[20] 61 F.C.C. 2d at 653.

[21] *Id.* at 658.

[22] *Id.* at 659.

PAK supported a finding of lawfulness under the zone of reasonableness test we applied under Section 201(b) of the Act [23] to Bell's other services. Since we had held TELPAK unjustified by competitive necessity, we did not rule on whether its return level was lawful.

44. We state at the outset that our Decision's holding on the lawfulness of TELPAK as a specific response to private microwave and private line competition finds ample support in the record. We note with concern, however, that the largest TELPAK customers (ARINC, ATA, AIA and DoD) [24] contend that our 1964 TELPAK decision [25] and certain subsequent orders indicated that we would consider only the compensatory/beneficial criterion of the competitive necessity test. They claim that they were not on clear and proper notice that the lawfulness of TELPAK as a "response" to competition continued at issue and that the evidence they presented on private microwave costs was directed solely to the compensatory/beneficial criterion.

45. The parties state the following as the basis for their notice claims. In 1964, when we first considered the TELPAK tariff in Docket 14251, we found "apparent competitive necessity" for the TELPAK C and D classifications. [26] We then held that the record in Docket 14251 would remain open to receive additional evidence on the question whether the rates therefor were compensatory. [27] During the twelve years between 1964 and our instant Decision, we issued orders by which we consolidated Docket 14251 with Phase I-B of Docket 16258; [28] we then consolidated the latter with Docket 18128. [29]

46. These and other orders contained language that the compensatory/beneficial criterion would be the primary focus of these further hearings, although we placed the lawfulness of TELPAK in general at issue under Section 202(a) of the Act. [30] The customer-petitioners argue that these orders did not put them on adequate notice of our intended ruling. Other parties maintain, however, that they were on notice; MCI claims notice was evident and Western Union states that the issue was encompassed in "broad statutory terms." [31] Indeed, even Bell offered findings on the issue. [32]

47. We believe our 1968 Memorandum Opinion and Order [33] designating the issues to be addressed in this proceeding was intended to encompass the overall lawfulness of the TELPAK rates under any rationale, including whether it was a proper response to competition. The record demonstrates that at least a number of major parties were aware of its scope and in fact argued the issue of competitive alternatives/responses. The evidence presented on private microwave costs, though relevant to the compensatory/beneficial criterion, is also di-

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[23] See *id.* at 649-50.

[24] Bell joins the user-parties only in asserting that the record proves that TELPAK is a lawful discrimination.

[25] 38 F.C.C. 370, 395, 37 F.C.C. 1111 (1964), *aff'd sub nom. American Trucking Ass'ns v. F.C.C.*, 377 F 2d 121 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967).

[26] 37 F.C.C. 1111, 1118-19 (1964).

[27] *Id.*

[28] 7 F.C.C. 2d 30, 31, (1966).

[29] 18 F.C.C. 2d 761, 764-65 (1969).

[30] 13 F.C.C. 2d 853, 858 (1968).

[31] Western Union Opposition, pp. 4-5.

[32] AT&T Proposed Findings and Conclusions, March 12, 1973, p. 365.

[33] *AT&T*, 13 F.C.C. 2d 853 (1968).

rectly related to the proper competitive response criterion. Furthermore, we cannot accept an interpretation of our 1964 TELPAK decision [34] to the effect that the proper competitive response criterion was settled in perpetuity at that time.

48. We recognize, however, that confusion on this point may have resulted from differing statements contained in orders issued during this somewhat convoluted and protracted proceeding.[35] We shall on this ground reconsider the matter of TELPAK's lawfulness as well as whether the return levels on these discounted rates fall within the zone of reasonableness.

49. Consequently, we set aside, and accordingly stay our Order requiring Bell to eliminate TELPAK by June 8, 1977 (61 F.C.C. 2d at 668) and will conduct an expedited hearing on the question of TELPAK's lawfulness in general under Sections 201(b) and 202(a) of the Act.[36]

50. In this connection, we reiterate the bases upon which the propriety of private line bulk discount rates will be judged.

51. In our 1964 Tentative Decision respecting TELPAK,[37] we stated that differences in rates directly attributable to differences in the cost of furnishing volumes of circuits vis-a-vis the other services, may justify a rate differential. *Id.* at 377, 379. We there concluded that TELPAK and the other private line services are like communication services, and that there were no material cost differences between such services furnished under TELPAK on a volume basis and those furnished under other private line tariffs on a circuit-by-circuit basis. *Id.* at 381.[38] In the absence of cost justification for the rate differentials between providing a like service in bulk or an individual circuit basis, rate discriminations may also be justified by meeting the competitive necessity test. *Id.* at 376. These holdings are consistent with our current holding that any bulk rates recover full cost over time and that competitive necessity may constitute the basis for a grant of a waiver. See 61 F.C.C. 2d at 659. Thus in the private line context in order for a carrier which provides both monopoly and competitive services to justify a discount rate to volume users of a private line service which is "like" non-discounted private line services, the following must be proved:

(1) The discriminatory bulk discount classifications must be cost justified, *i.e.*, it must be proved that there are material cost savings associated with provision of the service on a volume basis.

(2) The discount rate must be an exact reflection of such cost savings and must also be targeted to recover full costs on an FDC Method 7 basis.

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[34] 38 F.C.C. 370, 37 F.C.C. 1111 (1964), *aff'd sub nom. American Trucking Ass'ns v. F.C.C.*, 377 F.2d 121 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967).

[35] See generally: 38 F.C.C. 370 (1964); 37 F.C.C. 1111, 1118-1119 (1964); 6 F.C.C. 2d 177, 180 (1966); F.C.C. 68-388 (April 10, 1968); 13 F.C.C. 2d 853, 858 (1968).

[36] 47 U.S.C. §§ 201(b), 202(a) (1974).

[37] 38 F.C.C. 370, 37 F.C.C. 1111 (1964), *aff'd sub nom. American Trucking Ass'ns v. F.C.C.* 377 F.2d 121 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967).

[38] See also 37 F.C.C. 1111 (1964).

(3) Absent proof of cost justification, or upon departure from FDC Method 7 based rates which mirror actual cost savings, no discriminatory discount rates may be filed absent a waiver. Waivers may be granted upon proof that the rate differential is required by competitive necessity.

Thus the carrier is afforded the opportunity to compete fully and fairly in the competitive intercity private line marketplace evolving under our Specialized Common Carrier and Domestic Satellite Decisions.[39]

52. It is important to point out that cost differentials must be real and documentable. They cannot result from a fractionalization of demand, but must result from true cost savings associated with offering service in bulk. Discounted rates must be in proportion to actual cost savings and targeted to yield the company's authorized level of return. Other rates which may yield such a return, but are not tied to actual cost differentials, would not be acceptable. The appearance of having attained a lawful level of return cannot be sustained by "artificial and unwarranted service category structure" (61 F.C.C. 2d at 659). The same would be applicable to manipulations of "demand factors." *Ibid.* "Like services are not made different services merely because the level or structure of rates is different." 38 F.C.C. at 1114.

53. We now turn to the issue of whether the Telpak rates are compensatory, which we did not reach in our October Decision. It is argued that inasmuch as the *indicated* Telpak return levels for the twelve months ending September 30, 1975 were 8.5% under FDC Method 1 and 12.6% under FDC Method 7,[40] the TELPAK rates at that time were not unjust or unreasonable in relation to Bell's overall return level of 8.5%.

54. The problem with this line of reasoning is that it begs the basic question before us of the proper allocation of costs as between TELPAK and like communication services (*i.e.*, Series 2000 and 3000 private line services). We previously found that TELPAK was a like service (38 F.C.C. at 381) provided on a fungible basis via the same facilities and exhibiting the same basic costs as Series 2000/3000 services. Thus the TELPAK discount rate could only produce a higher actual return level than Series 2000/3000 services if (a) there are in fact significant cost savings in the bulk offering which were not evident in our previous determination or (b) there is in fact an "artificial and unwarranted service category structure" resulting in a fractionalization of demand. The record before us in the present proceeding does not provide the necessary segmentation and justification of costs as between like services provided under the TELPAK rate and those provided under the Series 2000/3000 rate to enable us to determine whether one or another of these factors is responsible for the indicated TELPAK return level. Absent such a determination, the lawfulness of the TELPAK rates or indicated return simply cannot be established.

55. We are mindful that Bell has filed a tariff revision cancelling TELPAK. Bell states that its reasons for this action are our Decision's holding that TELPAK was unlawful and Bell's *own* conclusion that

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[39] 29 F.C.C. 2d 870 (1971); 35 F.C.C 2d 844 (1972).
[40] See Bell Brief in Support of Exceptions, Appendix A.

> The imposition of unrestricted resale and sharing substantially changes the revenue/cost relationship for the TELPAK offering. . . . Thus, as we have pointed out (Transmittal No. 12714), TELPAK simply cannot continue in a resale and sharing environment. Bell Reply to Oppositions to Petitions for Reconsideration, p. 8; citations omitted.

In view of our grant of reconsideration, Bell is no longer under order to eliminate TELPAK. To this extent we stay and nullify paragraph 242 of our Decision. 61 F.C.C. 2d at 668. Consistent with this ruling we have waived Section 61.59 of our Rules and Regulations to permit Bell to withdraw the tariff revision cancelling TELPAK should Bell wish to do so. See our Memorandum Opinion and Order, F.C.C. 77-384, adopted June 2, 1977. In view of the uncertainty whether Bell will continue to offer TELPAK we must point out Bell's obligations. Pursuant to our Decision Bell was to file rates and rate levels in compliance with the Decision in all service categories. 61 F.C.C. 2d at 668. TELPAK, which we previously found unlawful, was exempted, although another replacement bulk offering could have been filed. Since Bell is no longer obliged to terminate TELPAK pursuant to our order and it may, at its option, continue to provide these discount rates, the TELPAK return levels must be adjusted to comply with our Decision. If the existing rates and classifications are continued, they must be shown to be lower, as stated previously, on the basis of actual cost differences from like private line services not offered in bulk and must also be targeted to yield the company's overall return. It is clear from our 1964 finding of "no material cost differences" (38 F.C.C. at 381) and the lack of any subsequent evidentiary offerings on this point that further expedited hearings would be necessary if TELPAK in its present form is to be continued, or if the present rates do not meet our full cost standard and have to be refiled to comply with same. In such event, in the context of the return level for *all* private line services, Bell will have to demonstrate actual cost savings and the ability of its new rates to meet the targeted return. If Bell seeks to depart from full costs we would entertain expedited proceedings under the competitive necessity test as a basis for a grant of a waiver. (This would be without prejudice to other bases that might be presented to justify a waiver.) We find in view of *Nader* v. *F.C.C.*, 520 F.2d 182 (D.C. Cir. 1975) that any further hearing to be held be on an expedited basis as follows:

> *First*, a separated trial staff will be designated to conduct the proceedings. *Second*, the Chief Administrative Law Judge will forthwith appoint an Administrative Law Judge to preside over these proceedings and to establish and adhere to an expedited schedule with direct certification of the record to the Commission for decision.[41] *Third*, the parties are instructed to limit their proof to matters not already in the record. Several petitions assert that certain studies on which our Decision was based are "out of date." Any new studies or submissions must therefore be shown to be based on data which will not be similarly criticized. We direct the parties and the Administrative Law Judge to adhere strictly to the rules of relevancy in this regard.

We note that it has already been established that TELPAK is not a separate service employing separate facilities or experiencing wholly separate costs from other private line service. See 38 F.C.C. 370, 381

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[41] We find that due and timely execution of our functions imperatively and unavoidably requires that an initial decision by the Administrative Law Judge be omitted. See 5 U.S.C. § 557(b)(2) (1976).

(1964); 61 F.C.C. 2d at 659. Thus, any attempt to prove that TELPAK is compensatory must first demonstrate how its cost differ from other private line services which have been determined to be non-compensatory. If Bell seeks to justify departures from full costs on the basis of competitive necessity, the following sets forth the standard to which evidence on this question should be directed.

56. To justify rate discrimination on the basis of competitive necessity, the carrier must evince the existence and extent of alternative telecommunications supply sources, on a route-by-route basis, citing demand, production, financial and other considerations which would impact these sources feasibility. The carrier should address alternative supply sources such as private microwave system (PMW) or other private line alternatives. It must be shown that a particular user's or user group's internal demand, in terms of its absolute size, variability, and growth characteristics, is economically sufficient to justify any cited alternative. Demand by route and length of haul must be demonstrated as well as economic considerations, service quality, reliability and flexibility determinants. On the supply side, the ability and willingness of the individual users or user group to build, operate and maintain a PMW system must be demonstrated. In this regard, it must be shown that specialized equpment is available in the quantity and quality desired, and within the relevant time frame. Further, a definitive route-by-route plan to satisfy the user's projected telecommunications needs must be made, including right of way and site, frequency, duct, or other congestion considerations. Financially and as a matter of policy, the ability and willingness of a user to undertake alternatives, commit funds, and bear any risks of obsolescence must be manifest. Users should demonstrate the availability of necessary lines of credit, external equity, or internal financial sources of funds sufficient to develop and employ alternatives. The need for and availability of specialized services from other common carriers must be demonstrated in the light of the above criteria, if such services are being considered as alternatives to TELPAK.

57. Petitioners also assert that our 1964 TELPAK decision was *res judicata* and cannot be disturbed. It is claimed that we are barred from deciding the question whether TELPAK is a proper competitive response in today's marketplace. While this argument was raised in the context of our October Order's finding that the TELPAK discrimination had not been justified in terms of this criterion, we recognize this same issue in the context of rehearing. Accordingly, we hold that *res judicata* does not apply herein, and that our finding twelve years ago of "apparent" competitive necessity should not be forever binding or prevent renewed consideration of this question.

58. Our past decisions on the lawfulness of TELPAK were ratemaking and as such an action under our delegation of legislative power. *Res judicata* has been held not to apply to an agency's legislative action in the context of rate cases. The Supreme Court has stated as early as 1929 that "[a] rate order is not *res judicata*. Every rate order may be superseded by another." *Tagg Bros.* v. *United States*, 289 U.S. 420, 445 (1929). Other federal appellate cases support our determination that we are not barred from reconsidering our 1964 decision. *Borough of Lansdale, Pa.* v. *Federal Power Com'n*, 404 F.2d 1104 (D.C. Cir. 1974) discusses whether summary "rejection" of a rate schedule should preclude refiling and reconsideration of the schedule in a subse-

quent proceeding. Noting that the case presented a probable error of law, the Court stated:

> . . . [T]he appropriateness of a rate schedule typically depends on factual circumstances and policy considerations which change drastically, and often quite rapidly over time. A doctrine barring all reconsideration would seem contrary to sound regulatory policy. 404 F.2d at 1115, n. 45.

59. ARINC cites *United States* v. *Utah Construction and Mining Co.*, 384 U.S. 394, 424 (1966) as authority for its position that we are bound by *res judicata*. The case reveals, however, that the administrative action must be one of adjudication in a "judicial capacity," not legislative action. *Cf.*, *Arizona Grocery* v. *Atchison Ry.*, 284 U.S. 370, 387 (1931).

60. Further, a decision must be final and on the merits before it may constitute a bar to later proceedings.[42] Our tentative decision in the original TELPAK proceeding was not a final decision. Subsequent orders state that due to an insufficient evidentiary showing we were unable to decide whether TELPAK C and D were compensatory and ordered that the record in Docket No. 14251 remain open to receive further evidence on this question.[43] Moreover, we reject statements by Bell and other petitioners that the 1964 decision was "court approved" in the *American Trucking* case and therefore could not be altered or reconsidered in subsequent Commission orders. That decision did not reach our findings as to TELPAK classifications C and D which are now at issue, but only our holding on the "like services" question and the lawfulness of classifications A and B:

> [S]ince the disposition of sections C and D of the Telpak tariff is not before us on this appeal, we need not consider this phase of the matter. *American Trucking Ass'ns* v. *F.C.C.*, 377 F.2d 121, 129 (D.C. Cir. 1966), *cert. denied*, 386 U.S. 943 (1967).

We accordingly find that *res judicata* would not bar reconsideration of TELPAK's lawfulness as a proper response to competition.

61. In conclusion, on reconsideration we find that the Telpak discounts, now subject to termination at the carrier's option, have not yet been justified on the basis of either a cost differential, an overall return level, or competitive necessity. Such justification will be the subject of the further hearings we are ordering herein.

IV. The Lawfulness of Other Rate Actions

A. Teletypewriter Station Equipment Rates and the Telpak Telegraph/Telephone Equivalency Ratio

62. ARINC (Petition, pp. 20-21) requests that we decide the lawfulness of rate increases for (1) teletypewriter station equipment rates and (2) the reduction in the Telpak telegraph-to-voice equivalency from 12:1 in the original Telpak rates to 6:1 in the September 1968 rates to 2:1 in the present Telpak tariff.

63. The teletypewriter station equipment rates at issue in this proceeding became effective on November 1, 1968. A list of these rates and the earlier rates which they superseded is found in Bell's Proposed Findings on pages 282 and 283. Bell's justification for its choice of rates is set forth in Bell's Exhibit 7 and proposed findings (pp. 278-88).

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[42] See *United States* v. *U.S. Smelting Co.*, 339 U.S. 186, 198 199 (1950).
[43] 37 F.C.C. 1111, 1118-19 (1964).

Cost studies were also offered as justification (Docket 16258: Bell Exh. 24A, 24B, 46; F.C.C. Staff Exh. 38, Tab 4) as well as evidence on competitors' products and prices in relation to some of the Bell equipment subject to the rate increase.

64. Bell relies on Full Additional Costs (FAC), the predecessor of LRIC (see Docket 18128, Bell Exh. 3, p. 4) to justify these increases. Bell P. F., pp. 280-81. The infirmities of LRIC, which we have detailed in our Decision (61 F.C.C. 2d at 632-33), are also present in FAC. FAC as a costing methodology is not sufficiently reliable to provide adequate justification for the specific tariff changes at issue. Bell performed a FAC study to support the teletypewriter exchange equipment increases. As ARINC pointed out (ARINC P.F., pp. 119-20), this study is seriously flawed; therefore, even if the FAC methodology was satisfactory, for the reasons observed by ARINC the study itself is unacceptable. Accordingly, Bell has not met its burden of proof and the subject rate increases are found unlawful.

65. Bell claims that the changes in the TELPAK telegraph-to-voice equivalency ratio are completely justified (Bell Opposition, footnote p. 4). ARINC, on the other hand, claims that by changing the number of telegraph channels per voice channel available to a customer, AT&T has "hidden" a significant rate increase. Bell has attempted to justify this (Bell Exh. 2, pp. 30-34) on the basis of increased telegraph terminal costs, and a "rationalization" of the TELPAK rate structure with the stated objectives of reducing "churning" of facilities and services, encouraging efficient use of transmission capacity within each voice-grade channel and equalizing the revenue-cost relationship (on a LRIC basis) of the telephone and telegraph portions of the offering. (See Bell P. F., pp. 219-23.)

66. We find that the changes in the ratio had the effect of a rate increase and that the evidence offered by Bell is insufficient to justify this rate increase. Bell's arguments concerning the purported problems with the rate structure and the need to correct them (its "rationalization") are without proper support in the record. The evidence represents only Bell's judgment, without the underlying facts. The effect on customers and the market in general are not addressed in any meaningful fashion (*e.g.*, no substantive market studies of the effects of such changes were offered). Further, the LRIC-based cost estimates are found invalid in the light of our Decision.[44] We therefore hold these tariff changes unlawful, and require that they be refiled under Method 7. Costs for individual rate elements must be derived on a Method 7 basis. While we do not require at this time that the rates for particular tariff components be designed to yield the allowed overall rate of return, we note that such matters are subject to determination in other proceedings such as Docket 19149.

B. The May 4, 1972 Rate Increases

67. On December 6, 1971, AT&T filed rate revisions to its private line telephone, telegraph and TELPAK rates. These revisions went into effect on May 4, 1972. ARINC (ARINC P.F. pp. 122-24), UPI

[44] We noted in our Decision that there may be possible applications for marginal cost pricing (61 F.C.C. 2d at 587, 626) subject to certain conditions. However, Bell's proposed LRIC did not constitute an acceptable application of marginal costing principles.

(UPI P.F. pp. 8-10) AP (AP P.F. pp. 5-11) and other parties have requested a determination on the lawfulness of these rate changes, particularly installation charges, terminal equipment charges and CCSA charges. These are rate element questions, as opposed to questions of the overall return level of a particular service. We affirm our findings that the present return levels for private line telephone and private line telegraph are deficient. 61 F.C.C. 2d at 651, 652. Further, the past earnings of private line telephone were inadequate and private line telegraph showed mixed results. *Id.* at 652. We did not reach the question whether TELPAK is compensatory, although we found no basis to order refunds based on the facts before us (*id.* at 659) and we have now ordered rehearing.

68. The pertinent question, however, is the just and reasonable nature of increases in specific rate elements of these tariffs. Although the overall return levels were not excessive, it is still possible that the rates for certain tariff elements were not justified. Users or classes of users who have a greater need for particular rate elements may have borne a disproportionate share of the total cost of the service and may have been discriminated against. Therefore, we must still reach the question of specific rate increases, even though the overall return level of a service was deficient.

69. In this instance too, AT&T has relied largely on long-run incremental costs and its attendant burden test to justify the pricing changes in these rate elements (see Bell P.F., pp. 223-330). The deficiencies of LRIC make such studies unacceptable as justification for the increased charges. Therefore, we hold these rate changes unlawful, to the extent that Bell has not met its burden of proof in justifying these rate elements.

70. For the future we expect Bell to provide costs developed according to Method 7 principles and to refile its rates and supporting material in accordance herewith. Rate elements, unlike the overall service categories, need not be priced to yield the overall allowed company-wide rate of return at this time. However, as we noted above, the matter of return levels for particular rate elements is subject to determination in other proceedings.

V. Additional Issues

A. Consistency of Dockets 18128 and 19129

71. USTS asserts that our use of Method 7 is inconsistent with our holding concerning plant under construction in Docket 19129. In Docket 19129, we found that "public interest considerations require that those who receive the benefits of certain investment items should pay the associated costs at the time the benefits accrue."[45] USTS contrasts this statement with the historical cost causation-based Method 7, which USTS claims "disregards the question of assigning plant responsibility to the *current* ratepayers using that plant irrespective of what the company's intention was at the time it was constructed."[46] We find USTS' contention without merit. Method 7 fully

[45] American Telephone and Telegraph Company, F.C.C. 77-150, 64 F.C.C. 2d ——, released March 1, 1977, p. 79, par. 149.

[46] USTS Petition for Reconsideration, p. 7, emphasis in original.

distributed costing allocates the full costs of service for a test year. The finding in Docket 19129 cited by USTS refers to the criteria for allowing plant under construction *into* the rate base. Determination of the rate base and Method 7 allocation are serial. The rate base is determined first, then it is allocated to the various service categories under Method 7. We perceive no inconsistancy between the two decisions.

B. The "Accommodation Theory"

72. ATA has requested that we give further consideration to its "Accommodation Theory" presented as an alternative to Bell's LRIC Method. Briefly, the "Accommodation Theory" sets a rate ceiling for monopoly services and a rate floor for competitive services. The competitive services must be priced at least to cover the long-run incremental costs attributed to them on a cost causation basis. The monopoly services may cover up to the remaining costs of the firm's operation. The monopoly service ceiling is equal to the competitive services. This purportedly protects the monopoly users. If the competitive services earn more than their incremental costs, such contributions reduce the costs which must be recovered from the monopoly users. Revenue shortfalls caused by insufficient earnings by the competitive services would be borne by Bell's shareholders.

73. We rejected the Accommodation Theory largely because it suffers from a number of the shortcomings of long-run incremental costs specified in our Decision. For example, it does not address the problems we have with LRIC in terms of equity, accountability, fair competition and clarification of market rules. See 61 F.C.C. 2d at 609-18. Further, it has most of the characteristics of the "basic service philosophy" which we also rejected (*id.* at 634-38). It treats classes of users on an unequal basis and allows for the carrier's determination of which customers shall be considered the marginal users and thus given special rate treatment. While we observed that the Accommodation Theory has attributes of historical causation (*id.* at 661, n. 129) and some elements of accountability (*id.* at 638, n. 81) insofar as certain shortfalls may purportedly pass directly to Bell stockholders, we concluded that it was nevertheless inferior to FDC Method 7, for the reasons indicated.

C. The Applicability of Method 7 to Carriers Other Than AT&T

74. Western Union, in its Petition (p. 5), claims uncertainty surrounding the application of Method 7 to itself "and other Bell competitors." We have already held Method 7 applicable to Western Union (61 F.C.C. 2d at 668), at least insofar as determination of costs are concerned. The determination of the costs of Western Union's services is central to determining whether any interservice subsidies exist and, if so, whether they are lawful, as well as whether waivers from its full costs are warranted. Respecting the applicability of Method 7 to other carriers, this issue is not before us. We have, however, indicated our preference for this method and held it applicable to Western Union and Bell, multiservice carriers with both monopoly and competitive offerings.

D. Refunds for Telpak

75. We have been requested by a number of the user parties to determine whether the increases in the TELPAK rates during the pendency of this case were lawful and whether refunds are due in view of the indicated levels of return over time. Our Decision did not reach this question on TELPAK return levels in view of our holding that the specific TELPAK tariff constituted an unjustified competitive response. 61 F.C.C. 2d at 659. On reconsideration we have found it necessary to hold further proceedings. Consequently, we set aside paragraph 243 of our Decision. *Id.* at 669.

E. Preferential Rates for DoD

76. Preferential rates for DoD are not at issue in this proceeding. If DoD seeks preferential rates, it may appropriately petition the Commission under Section 201(b) of the Act.

VI. ORDER

77. Accordingly, IT IS ORDERED, That the Petitions for Reconsideration are GRANTED IN PART to the extent indicated herein and otherwise, DENIED.

FEDERAL COMMUNICATIONS COMMISSION,
VINCENT J. MULLINS, *Secretary.*

APPENDIX I

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1979

No. 77-1333

AERONAUTICAL RADIO, INC., et al., *Petitioner*

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *Respondents*

AMERICAN BROADCASTING COS., INC., et al., AMERICAN TELEPHONE AND TELEGRAPH CO., MICROWAVE COMMUNICATIONS, INC., WESTERN UNION TELEGRAPH COMPANY, *Intervenors*

77-1521

AERONAUTICAL RADIO, INC., and AIR TRANSPORT
ASSOCIATION OF AMERICA, *Petitioners*

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *Respondents*

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, CONSOLIDATED RAIL CORPORATION, MICROWAVE COMMUNICATIONS, INC. AND MCI TELECOMMUNICATIONS CORP., AMERICAN NEWSPAPER PUBLISHERS, et al., *Intervenors*

77-1544

GENERAL ELECTRIC COMPANY, *Petitioner*

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *Respondents*

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
MICROWAVE COMMUNICATIONS, INC., et al., *Intervenors*

78-1368

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, *Petitioner*

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *Respondents*

AMERICAN BROADCASTING COMPANY, INC. & CBS, INC., &
NATIONAL BROADCASTING COMPANY, INC.,
DOW JONES & CO., INC., *Intervenors*

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL COMMUNICATIONS COMMISSION

Before: BAZELON, Senior Circuit Judge, ROBB and WILKEY, Circuit Judges

Judgment

(filed June 24, 1980)

These causes came on to be heard on the petitions for review of orders of the Federal Communications Commission and were argued by counsel. On consideration of the foregoing, it is

ORDERED AND ADJUDGED by this Court, that the orders of the Federal Communications Commission under review are affirmed in part, vacated in part and reversed in part, and the case is remanded to the commission for further proceedings, all in accordance with the opinion of this Court filed herein this date.

Per Curiam
For the Court:

/s/ GEORGE A. FISHER
George A. Fisher
Clerk

Date: June 24, 1980
Opinion for the Court filed by Circuit Judge Robb
Opinion filed by Circuit Judge Wilkey, dissenting in part.

APPENDIX J

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1980

No. 77-1333

AERONAUTICAL RADIO, INC., et al., *Petitioners*

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *Respondents*

AMERICAN BROADCASTING COS., INC., et al., AMERICAN TELEPHONE AND TELEGRAPH CO., MICROWAVE COMMUNICATIONS, INC., WESTERN UNION TELEGRAPH COMPANY, *Intervenors*

AND CONSOLIDATED CASES

Before: Bazelon, Senior Circuit Judge; Robb and Wilkey, Circuit Judges

Order

(filed November 26, 1980)

Upon consideration of the petitions for rehearing filed herein by joint petitioners Aeronautical Radio, Inc., et al., by petitioner General Electric Company, and by respondent United States, under dates of July 8, 1980 (petitioners) and July 29, 1980 (respondent), respectively, it is

ORDERED, by the Court, that all three petitions for rehearing are denied.

Per Curiam
For the Court:

/s/ GEORGE A. FISHER
George A. Fisher
Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1980

No. 77-1333

AERONAUTICAL RADIO, INC., et al., *Petitioner*

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *Respondents*

AMERICAN BROADCASTING COS., INC., et al., *Intervenors*

And Consolidated Case Nos. 77-1544, 77-1521 and 78-1368

BEFORE: Bazelon, Senior Circuit Judge; Robb and Wilkey, Circuit Judges

Order

(filed January 27, 1981)

Upon consideration of respondent's (U.S.) petition for rehearing, and of the various responses filed thereto, it is

ORDERED, by the Court, that respondent's aforesaid petition for rehearing is denied.

Per Curiam
For the Court:

/s/ GEORGE A. FISHER
George A. Fisher
Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1980

No. 77-1333

AERONAUTICAL RADIO, INC., et al., *Petitioner*

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *Respondents*

AMERICAN BROADCASTING COS., INC., et al., *Intervenors*

And Consolidated Case Nos. 77-1544, 77-1521 and 78-1368

BEFORE: Bazelon, Senior Circuit Judge; Wright, Tamm, Robinson, MacKinnon, Robb, Wilkey, Wald, Mikva, Edwards, and Ginsburg, Circuit Judges

Order

(filed January 27, 1981)

The suggestion for rehearing *en banc* filed herein by respondent (U.S.) and the various responses thereto having been transmitted to the full Court and no judge in regular active service and no members of the panel having requested that a vote be taken with respect thereto, it is

ORDERED, by the Court, *en banc*, that respondent's aforesaid suggestion for rehearing *en banc* is denied.

Per Curiam
For the Court:

/s/ GEORGE A. FISHER
George A. Fisher
Clerk

APPENDIX K

Statutes and Regulations Involved

Communications Act of 1934:

§ 201. Service and charges

(a) It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio to furnish such communication service upon reasonable request therefor; and, in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes.

(b) All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful: *Provided,* That communications by wire or radio subject to this chapter may be classified into day, night, repeated, unrepeated, letter, commercial, press, Government, and such other classes as the Commission may decide to be just and reasonable, and different charges may be made for the different classes of communications: *Provided further,* That nothing in this chapter or in any other provision of law shall be construed to prevent a common carrier subject to this chapter from entering into or operating under any contract with any common carrier not subject to this chapter, for the exchange of their services, if the Commission is of the opinion that such contract is not contrary to the public interest: *Provided further,* That nothing in this chapter or in any other provision of law shall prevent a common carrier subject to this chapter from furnishing

reports of positions of ships at sea to newspapers of general circulation, either at a nominal charge or without charge, provided the name of such common carrier is displayed along with such ship position reports. The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this chapter.

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§ 202. Discriminations and preferences

(a) *Charges, services, etc.*

It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

(b) *Charges or services included*

Charges or services, whenever referred to in this chapter, include charges for, or services in connection with, the use of common carrier lines of communication, whether derived from wire or radio facilities, in chain broadcasting or incidental to radio communication of any kind.

(c) *Penalty*

Any carrier who knowingly violates the provisions of this section shall forfeit to the United States the sum of $500 for each such offense and $25 for each and every day of the continuance of such offense.

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§ 203. Schedules of charges

(a) *Filing; public display*

Every common carrier, except connecting carriers, shall, within such reasonable time as the Commission shall designate, file with the Commission and print and keep open for public inspection schedules showing all charges for itself and its connecting carriers for interstate and foreign wire or radio communication between the different points on its own system, and between points on its own system and points on the system of its connecting carriers or points on the system of any other carrier subject to this chapter when a through route has been established, whether such charges are joint or separate, and showing the classifications, practices, and regulations affecting such charges. Such schedules shall contain such other information, and be printed in such form, and be posted and kept open for public inspection in such places, as the Commission may by regulation require, and each such schedule shall give notice of its effective date; and such common carrier shall furnish such schedules to each of its connecting carriers, and such connecting carriers shall keep such schedules open for inspection in such public places as the Commission may require.

(b) *Changes in schedule; discretion of Commission to modify requirements*

(1) No change shall be made in the charges, classifications, regulations, or practices which have been so filed and published except after ninety days notice to the Commission and to the public, which shall be published in such form and contain such information as the Commission may by regulations prescribe.

(2) The Commission may, in its discretion and for good cause shown, modify any requirement made by or under the authority of this section either in particular instances or by general order applicable to special circumstances or

conditions except that the Commission may not require the notice period specified in paragraph (1) to be more than ninety days.

(c) *Overcharges and rebates*

No carrier, unless otherwise provided by or under authority of this chapter, shall engage or participate in such communication unless schedules have been filed and published in accordance with the provisions of this chapter and with the regulations made thereunder; and no carrier shall (1) charge, demand, collect, or receive a greater or less or different compensation for such communication, or for any service in connection therewith, between the points named in any such schedule than the charges specified in the schedule then in effect, or (2) refund or remit by any means or device any portion of the charges so specified, or (3) extend to any person any privileges or facilities in such communication, or employ or enforce any classifications, regulations, or practices affecting such charges, except as specified in such schedule.

(d) *Rejection or refusal*

The Commission may reject and refuse to file any schedule entered for filing which does not provide and give lawful notice of its effective date. Any schedule so rejected by the Commission shall be void and its use shall be unlawful.

(e) *Penalty for violations*

In case of failure or refusal on the part of any carrier to comply with the provisions of this section or of any regulation or order made by the Commission thereunder, such carrier shall forfeit to the United States the sum of $500 for each such offense, and $25 for each and every day of the continuance of such offense.

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(b) Notwithstanding the provisions of subsection (a) of this section, the Commission may allow part of a charge, classification, regulation, or practice to go into effect, based upon a written showing by the carrier or carriers affected, and an opportunity for written comment thereon by affected persons, that such partial authorization is just, fair, and reasonable. Additionally, or in combination with a partial authorization, the Commission, upon a similar showing, may allow all or part of a charge, classification, regulation, or practice to go into effect on a temporary basis pending further order of the Commission. Authorizations of temporary new or increased charges may include an accounting order of the type provided for in subsection (a) of this section.

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§ 204. Hearings on new charges; suspension pending hearing; refunds

(a) Whenever there is filed with the Commission any new or revised charge, classification, regulation, or practice, the Commission may either upon complaint or upon its own initiative without complaint, upon reasonable notice, enter upon a hearing concerning the lawfulness thereof; and pending such hearing and the decision thereon the Commission, upon delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such charge, classification, regulation, or practice, in whole or in part but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearing the Commission may make such order with reference thereto as would be proper in a proceeding initiated after such charge, classification, regulation, or practice had become effective. If the proceeding has not been concluded and an order made within the period of the suspension, the proposed new or revised charge, classification, regulation, or practice shall go into effect at the end of such period; but

in case of a proposed charge for a new service or an increased charge, the Commission may by order require the interested carrier or carriers to keep accurate account of all amounts received by reason of such charge for a new service or increased charge, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such charge for a new service or increased charges as by its decision shall be found not justified. At any hearing involving a charge increased, or sought to be increased, the burden of proof to show that the increased charge, or proposed charge, is just and reasonable shall be upon the carrier, and the Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible.

§ 205. Commission authorized to prescribe just and reasonable charges; penalties for violations

(a) Whenever, after full opportunity for hearing, upon a complaint or under an order for investigation and hearing made by the Commission of its own initiative, the Commission shall be of opinion that any charge, classification, regulation, or practice of any carrier or carriers is or will be in violation of any of the provisions of this chapter, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge or the maximum or minimum, or maximum and minimum, charge or charges to be thereafter observed, and what classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent that the Commission finds that the same does or will exist, and shall not

thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed.

(b) Any carrier, any officer, representative, or agent of a carrier, or any receiver, trustee, lessee, or agent of either of them, who knowingly fails or neglects to obey any order made under the provisions of this section shall forfeit to the United States the sum of $1,000 for each offense. Every distinct violation shall be a separate offense, and in case of continuing violation each day shall be deemed a separate offense.

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§ 206. Carriers' liability for damages

In case any common carrier shall do, or cause or permit to be done, any act, matter, or thing in this chapter prohibited or declared to be unlawful, or shall omit to do any act, matter, or thing in this chapter required to be done, such common carrier shall be liable to the person or persons injured thereby for the full amount of damages sustained in consequence of any such violation of the provisions of this chapter, together with a resonable counsel or attorney's fee, to be fixed by the court in every case of recovery, which attorney's fee shall be taxed and collected as part of the costs in the case.

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§ 207. Recovery of damages

Any person claiming to be damaged by any common carrier subject to the provisions of this chapter may either make complaint to the Commission as hereinafter provided for, or may bring suit for the recovery of the damages for which such common carrier may be liable under the provisions of this chapter, in any district court of the United

States of competent jurisdiction; but such person shall not have the right to pursue both such remedies.

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§ 208. Complaints to Commission; investigations

Any person, any body politic, or municipal organization, or State commission, complaining of anything done or omitted to be done by any common carrier subject to this chapter, in contravention of the provisions thereof, may apply to said Commission by petition which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such common carrier, who shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission. If such common carrier within the time specified shall make reparation for the injury alleged to have been caused, the common carrier shall be relieved of liability to the complainant only for the particular violation of law thus complained of. If such carrier or carriers shall not satisfy the complaint within the time specified or there shall appear to be any reasonable ground for investigating said complaint, it shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall deem proper. No complaint shall at any time be dismissed because of the absence of direct damage to the complaint.

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§ 209. Orders for payment of money

If, after hearing on a complaint, the Commission shall determine that any party complainant is entitled to an award of damages under the provisions of this chapter, the Commission shall make an order directing the carrier to pay to the complainant the sum to which he is entitled on or before a day named.

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§ 214. Extension of Lines

(a) No carrier shall undertake the construction of a new line or of an extension of any line, or shall acquire or operate any line, or extension thereof, or shall engage in transmission over or by means of such additional or extended line, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line: *Provided,* That no such certificate shall be required under this section for the construction, acquisition, or operation of (1) a line within a single State unless such line constitutes part of an interstate line, (2) local, branch, or terminal lines not exceeding ten miles in length, or (3) any line acquired under section 221 or 222 of this Act: *Provided further,* That the Commission may, upon appropriate request being made, authorize temporary or emergency service, or the supplementing of existing facilities, without regard to the provisions of this section. No carrier shall discontinue, reduce, or impair service to a community, or part of a community, unless and until there shall first have been obtained from the Commission a certificate that neither the present nor future public convenience and necessity will be adversely affected thereby; except that the Commission may, upon appropriate request being made, authorize temporary or emergency discontinuance, reduction, or impairment of service, or partial discontinuance, reduction, or impairment of service, without regard to the provisions of this section. As used in this section the term "line" means any channel of communication established by the use of appropriate equipment, other than a channel of communication established by the interconnection of two or more existing channels: *Provided, however,* That nothing in this section shall be construed to require a certificate or other authorization from the Commission for any installation, replacement, or other changes in plant, operation, or equipment,

other than new construction, which will not impair the adequacy or quality of service provided.

(b) Upon receipt of an application for any such certificate, the Commission shall cause notice thereof to be given to, and shall cause a copy of such application to be filed with, the Secretary of Defense, the Secretary of State (with respect to such applications involving service to foreign points), and the Governor of each State in which such line is proposed to be constructed, extended, acquired, or operated, or in which such discontinuance, reduction, or impairment of service is proposed, with the right to those notified to be heard; and the Commission may require such published notice as it shall determine.

(c) The Commission shall have power to issue such certificate as applied for, to refuse to issue it, or to issue it for a portion or portions of a line, or extension thereof, or discontinuance, reduction, or impairment of service, described in the application, or for the partial exercise only of such right or privilege, and may attach to the issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require. After issuance of such certificate, and not before, the carrier may, without securing approval other than such certificate, comply with the terms and conditions contained in or attached to the issuance of such certificate and proceed with the construction, extension, acquisition, operation, or discontinuance, reduction, or impairment of service covered thereby. Any construction, extension, acquisition, operation, discontinuance, reduction, or impairment of service contrary to the provisions of this section may be enjoined by any court of competent jurisdiction at the suit of the United States, the Commission, the State commission, any State affected, or any party in interest.

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(d) The Commission may, after full opportunity for hearing, in a proceeding upon complaint or upon its own initiative without complaint, authorize or require by order any carrier, party to such proceeding, to provide itself with adequate facilities for the expeditious and efficient performance of its service as a common carrier and to extend its line or to establish a public office; but no such authorization or order shall be made unless the Commission finds, as to such provision of facilities, as to such establishment of public offices, or as to such extension, that it is reasonably required in the interest of public convenience and necessity, or as to such extension or facilities that the expense involved therein will not impair the ability of the carrier to perform its duty to the public. Any carrier which refuses or neglects to comply with any order of the Commission made in pursuance of this paragraph shall forfeit to the United States $100 for each day during which such refusal or neglect continues.

Rules and Regulations of the Federal Communications Commission:

§ 61.38 Material to be submitted with letters of transmittal by filing carriers.

(a) *Explanation and data supporting changes and/or new tariff offering.* The material to be submitted for a tariff change or for a tariff filing which is for a service not previously offered, shall include: (1) An explanation of the changed or new matter, the reasons for the filing, and the basis of ratemaking employed; and (2) economic data and information to support the changed or new matter including:

(i) For changed matter, a cost of service study for all elements of costs for the most recent 12-month period; and for changed and new matter a study containing a projection of costs for a 3-year period beginning at the date of the filing of the tariff matter; and

(ii) Estimates of the effects of the changed or new matter upon the carrier's traffic and revenues from the service to which the changed or new matter applies; upon the traffic and revenues from the other service classifications of the carrier; and upon the overall traffic and revenues of the carrier. Estimates should include the estimated effects on the traffic and revenue data for the most recent 12-month period and projections for a 3-year period beginning at the date of the filing of the changed or new matter. Complete explanations of the bases for the estimates should be provided.

(b) *Working papers and statistical data.* (1) There is to be furnished to the Chief, Common Carrier Bureau, upon filing of any tariff change or tariff filing which is for a service not previously offered, two sets of working papers for use by the staff and two sets of working papers which shall be available for use by the public at the Commission's offices. These working papers shall contain the information underlying the data supplied in response to paragraph (a) of this section. A clear indication shall be made as to how the working papers relate to information supplied in response to paragraph (a) of this section.

(2) All statistical studies will be submitted and supported in the form prescribed in § 1.363 of this chapter.

(c) *Submission of explanation and data by connecting carriers.* If the changed or new matter is being filed by the issuing carrier at the request of a connecting carrier, it will be the duty of the connecting carrier to provide the data and information in paragraphs (a) and (b) of this section on the date the tariff matter is filed with the Commission by the issuing carrier.

(d) *Form and content of material submitted with certain rate increases.* (1) For each rate increase in any service or tariffed item resulting in (i) a 10 percent or greater increase in annual revenues from that service or tariffed

item, and (ii) at least $100,000 in additional revenues, both calculated on the basis of existing quantities of service; or for two or more rate increases applying to the same service or tariffed item during any 12-consecutive-month period resulting in (*a*) a 10 percent or greater increase in annual revenues from that service or tariffed item, and (*b*) at least $100,000 in additional annual revenues, both calculated on the basis of existing quantities of service, the filing carrier shall submit all cost, marketing and other data on which it relies in justification of the rate increase and in an appropriate form to serve as the carrier's direct case in the event the rate increase is set for hearing initially scheduled to commence on a date within 6 months from the date of filing. If the rate increase is designated for hearing the carrier shall submit any additional information on which it relies in documentary form, within 45 days from the date of designation.

(2) The information and data requirement of subparagraph (1) of this paragraph shall be submitted for a rate increase in any service or tariffed item resulting in more than $1 million in additional annual revenues, as calculated on the basis of existing quantities of service, without regard to the percentage increase in such revenues.

(3) The requirement imposed here is in addition to any requirement imposed by the other provisions of this section.

(e) *Copies of explanation and data to customer.* Concurrently with the filing of any rate for special construction or special assembly equipment and arrangements which were developed on the basis of estimated cost, the filing carrier shall transmit to the customer a copy of the explanation and data required by paragraphs (a) and (b) of this section.

(f) *Exception.* The requirements of this section shall not apply to any carrier with annual gross revenues of less than $100,000.

§ 61.58 Notice requirements.

Every tariff publication or filing shall bear an effective date and, except as otherwise provided by regulation, special permission, or order of the Commission, shall give at least the number of days notice to the public and to the Commission specified hereinafter. If a new or revised tariff provision fits into more than one of the categories listed below, the longest period of public notice provided for shall apply. Notice shall be given by filing with the Commission such proposed tariff publications. In addition to this notice, if the tariff publication proposes to increase any charge or to effectuate an authorized discontinuance, reduction or other impairment of service to any customer, the filing carrier shall take such steps as are appropriate under the circumstances to inform the affected customers of the content of the tariff publication. Any period of notice required herein shall begin on and shall include the date the tariff is received by the Commission, but shall not include the effective date. In computing the notice required, Sundays and holidays shall be counted.

(a) Tariff filings involving a change in the name of a carrier, a change in V&H coordinates, corrections, a change in the lists of connecting, concurring or other participating carriers, text changes or the imposition of termination charges shall give not less than 15 day's notice to the public and to the Commission.

(b) Tariff filings involving a change in rate structure, a new service offering, or a rate increase shall give at least 90 day's notice to the public and to the Commission.

(c) All tariff filings not specifically assigned a different period of public notice in this part shall give at least 70 day's notice to the public and to the Commission.

(d) The Chief, Common Carrier Bureau may issue orders requiring the deferral of the effective date of any tariff filing made on less than 90 day's notice so as to pro-

vide for a maximum total of 90 day's notice to the public and to the Commission regardless of whether petitions opposing the tariff filing have been filed.

(e) If no petitions for suspension or rejection of a tariff filing are received by the date for filing petitions for suspension, the filing carrier may apply for Special Permission to refile the relevant tariff pages to become effective before the full period of public notice initially provided for has elapsed.